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February 13, 2012

Via e-mail

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**Re: Restrictions on Proprietary Trading and Certain Interests in and  
Relationships with Hedge Funds and Private Equity Funds**

**Comment Letter on Inappropriate Potential Application of Volcker Rule to  
Traditional Securities Lending Activities**

Federal Reserve Docket No. R-1432 and RIN 7100 AD 82  
FDIC RIN 3064-AD85  
OCC Docket ID OCC-2011-14  
SEC File No. S7-41-11  
CFTC RIN 3038-AD05

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Ladies and Gentlemen:

The Securities Lending Division of the Risk Management Association (“RMA”)<sup>1</sup> welcomes the opportunity to submit this letter to the Department of the Treasury, the Board of Governors of the Federal Reserve System (the “Board”), the Commodity Futures Trading Commission (the “CFTC”), the Federal Deposit Insurance Corporation (the “FDIC”), the Office of the Comptroller of the Currency (the “OCC”) and the Securities and Exchange Commission (the “SEC”) on behalf of several of its members who participate in

<sup>1</sup> The RMA Securities Lending Division acts as a liaison for RMA member institutions involved in agent lending functions within the securities lending industry, by providing products and services including hosting several forums, conferences and training programs annually and sharing aggregate composite securities lending market data free of charge.

the securities lending industry as agent banks.<sup>2</sup> These members include securities lending agents (“agent banks”) such as JP Morgan Chase & Co., The Bank of New York Mellon Corporation, Northern Trust Corporation and State Street Corporation, among others.

Section 619 of the Dodd-Frank Act<sup>3</sup>, commonly referred to as the “Volcker Rule”, broadly limits a bank’s authority to establish funds that are exempt from investment company registration under Sections 3(c)(1) or (7) of the Investment Company Act of 1940 (the “Investment Company Act” and such funds, “3(c)(1)/(7) funds”). RMA is concerned that the interagency Proposed Rulemaking<sup>4</sup> implementing the Volcker Rule could significantly (and we believe, inadvertently) impair the long-established securities lending activities of many of our members. As drafted, the Proposal could limit our members’ ability to establish private investment vehicles (“cash collateral pools”) on behalf of their securities lending clients to facilitate the investment of such clients’ cash collateral that is derived from securities lending transactions. In addition, RMA is concerned that the Proposal could be interpreted to prohibit borrower default indemnification, a traditional accommodation provided to certain clients by agent banks in connection with their securities lending programs.

This letter discusses why it is inappropriate for the Volcker Rule’s fund limitations to inhibit the operation of agent banks’ traditional securities lending activities, including pooled cash collateral investment and borrower default indemnification, and details some approaches to address these concerns.

**The analysis set forth in this letter supports the following conclusions:**

- The purpose of the Volcker Rule is to restrict federally insured banks from investing their own funds in speculative trading activity, which arguably puts banks’ own capital at risk and results in potential conflicts of interest.
- Congress vested the Agencies with authority to tailor the application of the Volcker Rule to exclude activities not within its intended purview.
- Cash collateral pools (domestic and foreign) are not of the type of activities intended to be limited by the Volcker Rule:

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<sup>2</sup> For purposes of this comment letter, we refer to the Board, the CFTC, the FDIC, the OCC and the SEC collectively as the “Agencies.”

<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (the “Dodd-Frank Act”). Section 619 amends the Bank Holding Company Act of 1956, 12 U.S.C. § 1841 et seq. (12 U.S.C. § 1851) (the “BHC Act”) by adding a new Section 13.

<sup>4</sup> Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (Nov. 7, 2011) (the “Volcker Proposal” or the “Proposal”). The CFTC released a separate set of proposed rules, which largely mirror the Proposal in content, on January 13, 2012. See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, *available at* <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister011112c.pdf>.

- Cash collateral pools do not involve investment of agent banks' own capital or the conflicts of interest that may result from such investments; and
  - As customary securities lending services, cash collateral pools are a long-standing, long-regulated banking product stemming from banks' custody, advisory and agent lending services.
- For a number of reasons, most significantly the overbroad definition of "covered funds" under the Volcker Proposal, agent banks may effectively be prohibited from establishing and managing bank cash collateral pools.
- The Agencies have the authority to remedy the inappropriate limitation on cash collateral pools by adopting any of the following approaches in the final rule text and/or preamble:
  - Exclusion of cash collateral pools from the definition of "covered fund" and clarification either that cash collateral pools are not construed as "banking entities" under the Proposal or that cash collateral pools are included in the securities lending exemption from the definition of "trading account"<sup>5</sup>;
  - Inclusion of cash collateral pools in the "customer fund" exemption of the Volcker Proposal and inclusion of the credit services that agent banks customarily provide to cash collateral pools in the "prime brokerage" exception of § 13(f) of the BHC Act (including § 13(f)(1), commonly called "Super 23A")<sup>6</sup>; and
  - Exemption of cash collateral pools from the Volcker Proposal's restrictions, including those under Super 23A, pursuant to the Agencies' authority under § 13(d)(1)(J) of the BHC Act.
- Indemnification of borrower defaults provided to certain clients by agent banks in connection with securities lending transactions are not prohibited under § \_\_.11(e) of the Proposal, and Super 23A does not prohibit such indemnification because such services either are not "covered transactions" subject to Super 23A or are exempt from Super 23A under the "prime brokerage" exemption.

In support of these conclusions, Section I of this letter summarizes the parties to and nature of a typical securities lending transaction involving a cash collateral pool and the size of the market more generally. Section II then discusses the purposes of the Volcker Rule, the

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<sup>5</sup> Our concern here is that, because the Proposal's definition of "banking entity" includes "Any affiliate or subsidiary of any entity described [in the definition]," other than covered funds exempt under the customer funds exemption in § \_\_.11 of the Proposal, cash collateral pools not exempt under § \_\_.11 that are affiliated with agent banks could be considered "banking entities" and thus prohibited directly from carrying out their buying and selling of high grade securities in accordance with lending clients' guidelines because of the proprietary trading prohibition of the Volcker Proposal. As discussed further in Section III.A., we submit that the proprietary trading prohibition of the Volcker Proposal should not be applicable to cash collateral pools given that no bank capital is invested and, as discussed in Section II.C., the collateral pool investments are made by the relevant bank acting in a fiduciary capacity pursuant to lending client guidelines.

<sup>6</sup> Volcker Proposal §§ \_\_.11(d), \_\_.16(a)(1).

authority Congress granted to the Agencies to tailor the statute in a manner that does not preclude traditional bank activities, such as providing securities lending services and establishing and managing cash collateral pools. Section III discusses the ways in which the substantive limitations of the Proposal could in fact (inappropriately) prohibit agent banks from managing these pools (Proposal Questions 6, 217 and 225 addressed). Section IV discusses the approaches identified above and how each ensures that the Proposal's reach is properly aligned with the intent of the Volcker Rule (Proposal Questions 217, 221, 223, 303, 307 and 316 addressed). Finally, Section V discusses the Volcker Rule's potential for inadvertent disruption of traditional bank securities lending activities, namely by precluding agent banks from providing borrower default indemnification to lending clients that are covered by the Proposal, as well as investors in such lending clients, and discusses why the final rule should expressly permit such activities to continue to occur.

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**I. Securities lending and investments by agent banks of cash collateral pools: Summary of parties, activity and market.**

Securities lending transactions are a traditional bank activity that supports global capital markets activities and facilitates trade settlement. By effectively increasing the supply of securities available for these and other market activities, securities lending improves global market liquidity and enhances price discovery.<sup>7</sup>

**A. Parties to securities lending transactions and nature of activities.**

Securities lenders largely consist of institutions such as public and private pension funds, ERISA plans, endowment funds of not-for-profit institutions, insurance companies, investment funds, and other similar entities or funds into which such entities invest. Borrowers in securities lending transactions largely consist of broker-dealers, banks and other financial institutions.

Through securities lending programs, agent banks act as intermediaries to facilitate loans of eligible securities by securities lenders (the clients of the agent banks, or “lending clients”) to qualified borrowers. Securities generally are lent pursuant to (i) a securities lending authorization agreement between the securities lender and the agent bank, and (ii) a securities borrowing agreement between the borrower and the agent bank. Pursuant to these agreements, the lending clients (and, directly or indirectly, the agent banks) have a security interest in and lien on the collateral, most frequently cash, provided by the borrower in an amount in excess of the value of the security borrowed, usually by a margin of 2% to 5% depending on certain characteristics of the security. These agreements also typically provide that lending clients (or their investors) are indemnified by the agent banks for any deficiencies in collateral in the event of a borrower default, usually in the form of failure to return the borrowed securities, commonly referred to as “borrower default indemnification.”

At the end of the loan, the securities lender must return to the borrower the same amount of cash collateral provided by the borrower. In periods when interest rates are more than de minimus, the securities lender pays the borrower a negotiated “loan rebate fee” on the cash collateral received. The securities lender receives all revenues from the pool (and, as described below, is responsible for all losses) that are allocated to its cash collateral invested, less the borrower’s loan rebate fee. A fee is paid to the agent bank that is generally a percentage of the lender’s net revenue from the cash collateral pool. A diagram showing the structure of a typical securities lending transaction is attached as Exhibit A.

A significant corollary to a securities lending transaction is the investment of cash collateral provided by a borrower to a lending client as security for the loan. Typically, the lending client authorizes the agent bank to invest, in its discretion, the lending client’s cash

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<sup>7</sup> See Securities lending transactions: market development and implications, report prepared by the Technical Committee of the International Organization of Securities Commissions and the Committee on Payment and Settlement Systems of the central banks of Group of Ten countries, International Organization of Securities Commissions and Bank for International Settlements (July 1999), *available at* <http://www.bis.org/publ/cpss32.htm>.

collateral, within certain parameters agreed with the lending client, commonly referred to as investment guidelines, and in accordance with any other restrictions under the securities lending authorization agreement. Such cash collateral investment is performed by the agent bank for the account of and at the risk of the lending client.

If the lending client elects, the cash collateral provided by a borrower as security for the loans attributable to such client is pooled by the agent bank with other cash collateral provided to other clients. These investment “pools” may exist in the form of trusts, partnerships, limited liability companies, or even separate accounts maintained by more than one party (in the case of such accounts, generally by related parties, such as multiple pension plans of a municipality). Because securities on loan can generally be recalled promptly by the lender, the collateral generally is invested in highly liquid securities. Cash collateral pools generally invest in highly rated fixed income securities, including U.S. and non-U.S. sovereign debt, such as U.S. Treasuries, U.S. government agency securities, and foreign sovereign debt, highly rated corporate debt and other similar types of securities. By pooling cash collateral, agent banks are able to defray investment management and other transaction costs (including costs of borrower default indemnification) for participating lending clients and afford them investment opportunities that otherwise may not be available. As part of pooled cash collateral management, agent banks have also traditionally provided short-term extensions of credit and contractual income and settlement services to lending clients and cash collateral pools to facilitate trade settlement and related cash collateral investment activities.<sup>8</sup>

One significant impact of the Volcker Rule and the Proposal’s limitation on establishing and maintaining cash collateral pools would be to marginalize participation by many lending clients (such as some public and private pension funds, ERISA plans and endowment funds of not-for-profit institutions). That is, if agent banks could no longer establish and maintain cash collateral pools (e.g., by having to “outsource” to a third party the custody of cash collateral pools and/or the related short-term credit services provided to the pools)<sup>9</sup>, participation in securities lending programs would only be cost effective for the largest lending clients. As a result, many small and intermediate securities lending clients would be denied the incremental revenue securities lending can provide, and securities lending programs could lose significant diversification in lending clients, lendable assets, borrowers and agent banks. Additionally, as securities lending revenues are generally used to defray costs of custodial, advisory and other services offered by agent banks to lending clients, the actual costs of such custodial or other services provided to clients that no longer participate in lending would increase.

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<sup>8</sup> Contractual settlement refers to the process by which an agent bank, in order to facilitate settlement of securities transactions, will credit the account of a collateral pool with proceeds due from a counterparty in anticipation of the agent bank’s receipt of those proceeds from the counterparty on the same day; the credit is provisional and is subject to reversal if the anticipated proceeds are not received in a timely fashion. Contractual income refers to the process by which an agent bank, in order to facilitate securities transactions, will credit the account of a collateral pool with proceeds of payments that the collateral pool expects to receive on the same day.

<sup>9</sup> It should be noted that while the “outsourcing” of custody or short-term credit services provided to cash collateral pools may seem appealing, such a strategy raises significant concerns in addition to the potential impacts addressed above. Importantly, concerns exist around protection of trade secrets as eligible third-party custodians would also likely be competitor agent banks and counterparty credit risks that may conflict with the Dodd-Frank Act’s efforts to reduce counterparty credit risk, e.g., Section 165 of the Dodd-Frank Act.

## **B. Overview of the securities lending market.**

In the U.S. lending market, cash is taken as collateral for more than 85% of securities loans.<sup>10</sup> Loans are over-collateralized by a margin of typically 2% to 5%, depending on the jurisdiction of the loaned securities' issuance and the type of collateral provided. Cash collateral is reinvested in securities, often in pools, in both the U.S. and abroad. Indeed, because some of those pools are established outside the U.S. to benefit lending clients, it is critical that the regulators adjust the language of the final rule to clearly allow both U.S. and non-U.S. cash collateral pools to be established.

Securities lending and the reinvestment of cash collateral have been a customary outgrowth of custody, advisory and related activities for decades, and, as discussed in further detail in Section II.C below, have been regulated, examined, and treated by regulators as traditional banking services for some time.

As of the third quarter of 2011, about \$2 trillion of securities were on loan in the global securities lending market.<sup>11</sup> RMA composite figures for the fourth quarter of 2011, compiling responses of 13 member banks, showed \$6 trillion of U.S. lendable assets and \$3 trillion of non-U.S. lendable assets in the securities lending market, of which over \$500 billion of U.S. securities and \$170 billion of non-U.S. securities were on loan against cash collateral.<sup>12</sup> If interrupted, this could materially impair access to securities, driving down liquidity and in turn impeding price discovery. The combined effect of such events could potentially lead to vast disruptions in the capital markets. At a minimum, if the final regulations implementing the Volcker Rule act to restrict U.S. agent banks from establishing cash collateral pools and providing other traditional corollary services to the pools and lending clients discussed in this letter, U.S. agent banks could lose significant market share of non-U.S. lendable assets to non-U.S. agent banks not subject to such restrictions. Moreover, as stated above, if agent banks were forced by an inappropriate application of the Volcker Rule to "outsource" cash collateral pools, or the related credit facilities, to other parties, it would be uneconomical for agent banks to offer securities lending services to all but the largest lending clients.

Agent banks acting as intermediaries in this activity (i.e., the RMA Members) include some of the largest banks in the world, such as JP Morgan Chase & Co., The Bank of New York Mellon Corporation, Northern Trust Corporation and State Street Corporation, among others. As the foregoing demonstrates, in establishing and operating these pools, these agent banks are engaging in a traditional, highly regulated bank activity without putting their own funds at risk, and performing a function that is critical to the U.S. (and global) economies.

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<sup>10</sup> See Bank of England Quarterly Bulletin 2011 Q3: Developments in the global securities lending market, available at [www.bankofengland.co.uk/publications/quarterlybulletin/qb110303.pdf](http://www.bankofengland.co.uk/publications/quarterlybulletin/qb110303.pdf) ("Bank of England Quarterly Bulletin"), Chart 2 at 226.

<sup>11</sup> Bank of England Quarterly Bulletin, id., at 224.

<sup>12</sup> RMA Quarterly Composite Data on Securities Lending, Fourth Quarter 2011, available to the Agencies upon request in connection with the Agencies' review of this Comment Letter and implementation of the Volcker Rule.



**II. The Volcker Rule: Purpose of the statute, intended applicability and reasons why cash collateral pools should not be impaired by the rulemaking.**

*Part A* of this section sets out the purposes of the Volcker Rule according to its legislative history and the study prepared by the Financial Stability Oversight Council (“FSOC”). *Part B* shows how Congress, the FSOC and the Agencies have agreed that the statute should not be interpreted to apply to all 3(c)(1)/(7) funds, but only those entities which are of the type the rule was intended to prohibit. *Part C* describes why cash collateral pools are not the type of activities the Volcker Rule was intended to prohibit and as such, on one or more of the multiple bases set forth in Section IV, should not be impaired in any way by the Proposal.

**A. Purposes of the Volcker Rule.**

Paul Volcker’s intent. In testimony to the Senate Banking Committee, Paul Volcker indicated that his major focus in crafting this provision of the Dodd-Frank Act was to limit banks’ proprietary investment of their capital. Specifically, he stated, “Curbing the proprietary interests of commercial banks is in the interest of fair and open competition as well as protecting the provision of essential financial services.”<sup>13</sup>

Purposes defined by the FSOC Study. As mandated by the Volcker Rule, the FSOC commissioned a study (the “FSOC Study”)<sup>14</sup> setting out the following three purposes of the Volcker Rule (emphasis added):

1. Separate federal support for the banking system from *speculative trading activity* with *banking entities’ own capital*;
2. Reduce potential *conflicts of interest* between banking entities and their customers; and
3. Reduce *risk* to banking entities and nonbank financial companies designated for supervision by the Board.

As the foregoing evidences, the purpose of the Volcker Rule is to restrict banking organizations from investing their own funds speculatively, because this type of activity both puts banking organization capital at risk and results in potential conflicts of interest between banks and their customers.

**B. Agencies’ authority, and duty, to tailor the Volcker Rule’s broad applicability so as not to cover all 3(c)(1)/(7) funds.**

The scope of the Volcker Rule’s prohibition against bank ownership or sponsorship of “private equity funds” and “hedge funds” hinges on the definition of those terms. Finding these types of entities difficult to define, legislators created an overbroad definition (i.e., using as a

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<sup>13</sup> S. Rept. 111-176 at 8. quoting testimony by Paul Volcker, former Federal Reserve Board Chairman and Chairman of the President’s Economic Recovery Advisory Board, to the Senate Banking Committee, 2/2/10.

<sup>14</sup> Financial Stability Oversight Council, *Study & Recommendations on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds* (Jan., 2011). at 8.

basis all 3(c)(1)/(7) funds) that left ambiguity as to how it should be applied by regulators. However, as this section demonstrates, Congress clearly indicated that it expected the Agencies to use their authority to ensure that entities not intended to be restricted were not captured by the Volcker Rule's prohibitions. The Agencies have recognized this directive, but, as further discussed in Section III, the Proposal should be revised to exclude more appropriately the types of funds that were not intended to be covered by the broad reach of the Volcker Rule.

*Legislative history shows drafters intended regulators to narrow the scope of the Volcker Rule's applicability.*

The legislative history of the Dodd-Frank Act shows that Congress intended the Volcker Rule to apply only to traditional hedge funds and private equity funds, and that regulators should use their rulemaking authority to exempt other vehicles inappropriately or unintentionally covered by the overbroad definition of "private equity funds" and "hedge funds" as 3(c)(1)/(7) funds. Several congressional colloquies evidence this intent.

For example, Representative Jim Himes (D-CT) pointed out that this definition "***could technically apply to lots of corporate structures, and not just the hedge funds and private equity funds.***" When Representative Himes specifically asked for confirmation that the Volcker Rule wouldn't deem subsidiaries or joint ventures used by firms to hold other investments to be hedge funds or private equity funds under the Volcker Rule, House Financial Services Chairman Barney Frank (D-MA) responded "... We do not want these overdone. We don't want there to be excessive regulation. And the distinction the gentleman draws is very much in this bill, and we are confident that the ***regulators will appreciate that distinction, maintain it***, and we will be there to make sure that they do."<sup>15</sup>

Furthermore, Representative Anna Eshoo (D-CA) also indicated that the Agencies should narrow the statutory definition by her statement, "***I expect the regulators to use the broad authority in the Volcker Rule wisely and clarify*** that funds that invest in technology startup companies, such as venture capital funds, are not captured under the Volcker Rule and ***fall outside the definition of 'private equity funds'.***"<sup>16</sup>

Similarly, Senator Barbara Boxer (D-CA) sought confirmation that the intent of the rule is not to harm venture capital investment. Senate Banking Committee Chairman Christopher Dodd (D-CT) responded by stating that "... [P]roperly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would ***expect the appropriate Federal regulators to exempt it using their authority under section 619[d](1)(J).***"<sup>17</sup>

<sup>15</sup> Colloquy Between Senate Banking Committee Chairman Christopher Dodd and Senator Barbara Boxer, 156 Cong. Rec. S5904 (daily ed. July 15, 2010).

<sup>16</sup> 156 Cong. Rec. E1295 (daily ed. July 23, 2010) (emphasis added).

<sup>17</sup> Colloquy Between House Financial Services Chairman Barney Frank and Representative Jim Himes, 156 Cong. Rec. H5226 (daily ed. June 30, 2010) (emphasis added).

This sampling of legislative history reflects that Congress intended the statute, as implemented by the Agencies, to draw a distinction between true private equity funds and hedge funds and other 3(c)(1)/(7) funds. This distinction should be maintained by the Agencies either by ensuring such other funds “fall outside the definition” of private equity funds and hedge funds or by “using their authority under section [13(d)(1)(J) of the BHC Act]” to exclude such other funds.

The RMA submits that the basis for tailoring the final rule to exclude cash collateral pools is even more compelling than the legislative history cited above suggests. The above examples concern joint venture and subsidiary investment vehicles and venture capital investments, none of which are considered traditional bank activities. Given the fact that collateral pools are customary bank activities that were historically an outgrowth of banks’ custody and advisory services and have for years been an integral part of any lending agent’s role (whether custodial or non-custodial), there is an even stronger argument to exclude these from the Volcker Rule’s prohibitions.

*Implementing the Congressional mandate to tailor regulations.*

In a move that showed Congress believed the Agencies had authority to narrowly tailor the statute to its purposes, Congress included a provision in the statute commissioning the FSOC Study and requiring the FSOC to make recommendations on implementing the Volcker Rule based on the study.<sup>18</sup> Congress also directed the Agencies to consider the study in their rulemaking.<sup>19</sup>

In the FSOC Study the statutory definition of private equity funds and hedge funds was discussed, in part, by noting that “Although [3(c)(1)/(7) are] widely used by traditional hedge funds and private equity funds, these statutory exclusions were not designed to apply only to such funds. As such, they do not specifically address or closely relate to the activities or characteristics that are typically associated with hedge funds or private equity funds. In implementing the Volcker Rule, Agencies should consider criteria for providing exceptions with respect to certain funds that are technically within the scope of the “hedge fund” and “private equity fund” definition in the Volcker Rule but that Congress may not have intended to capture in enacting the statute.”<sup>20</sup> The FSOC Study further recommended “that Agencies carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in section 3(c)(1) or 3(c)(7) and consider whether it is appropriate to narrow the statutory definition by rule in some cases.”<sup>21</sup>

Thus, the FSOC Study finds the statutory definition of private equity funds and hedge funds overbroad and recommends that the Agencies use their regulatory authority to narrow the definition’s scope, by identifying criteria of 3(c)(1)/(7) funds that are also hedge funds or private equity funds, or by rule creating specific exclusions for 3(c)(1)/(7) funds not intended to be

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<sup>18</sup> BHC Act § 13(b)(1).

<sup>19</sup> BHC Act § 13(b)(2)(A).

<sup>20</sup> FSOC Study at 7.

<sup>21</sup> FSOC Study at 62.

captured by the Volcker Rule. Agencies have acknowledged the FSOC Study's conclusions by asking in Question 221<sup>22</sup> of the Proposal for comment on whether to define private equity funds and hedge funds by reference to their characteristics. As discussed above, we believe that the Agencies possess sufficient authority to tailor the scope of the Volcker Rule in a manner consistent with the conclusion of the FSOC Study and the purposes of the Volcker Rule.

Although statutory text is ambiguous as to how this should be effected, application of Chevron principles should lead to a narrowing of the scope of the final rule.

As discussed at length above, it is eminently clear that neither Congress nor the FSOC intended all 3(c)(1)/(7) funds to be covered by the Volcker Rule. The Proposal's summary of the definition of "covered fund" noted that reliance on the 3(c)(1) and 3(c)(7) exclusions results in an overbroad definition: "Sections 3(c)(1) and 3(c)(7) of the Investment Company Act... are commonly relied on by a wide variety of entities that would otherwise be covered by the broad definition of "investment company" contained in that Act. As a result, the statutory definition in §13(h)(2) of the BHC Act could potentially include within its scope many entities and corporate structures that would not usually be thought of as a 'hedge fund' or 'private equity fund'." In other words, the legislative history and related material make two distinct but related points clear: (1) Congress intended the Agencies to limit the scope of the 3(c)(1)/(7) definition, but (2) subject to the general objectives of the Volcker Rule stated above, Congress left to the Agencies exactly how it should be narrowed. *Chevron*<sup>23</sup> is clear as to the appropriate Agency response to Congress' actions.

First, *Chevron* provides that Agencies must follow Congress' intent in their construction of a statute, if "Congress has directly spoken to the precise question at issue." We submit that Congress has in fact directly addressed this question, and, as noted above, has indicated that the statutory prohibitions should not cover 3(c)(1)/(7) funds that do not share the characteristics generally ascribed to traditional hedge funds and private equity funds. Thus, the Agencies are required by *Chevron* to use their rulemaking authority to narrow the scope of the overbroad statutory definition.

Second, *Chevron* also provides that, where Congress has not directly addressed an issue, if the statute is silent or ambiguous with respect to the specific issue, the court must give deference to the relevant agency's answer if it is based on a "permissible construction of the statute."<sup>24</sup> We submit that, as recognized by the Agencies, the statutory text is ambiguous as to how funds not intended to be covered by the Volcker Rule should be excluded from its reach, and Congress did not give clear direction as to how to (in the words of Representative Frank) "appreciate this distinction" and "maintain it." Indeed, as noted above, Representative Eshoo seemed to suggest a narrowing of the definition of "private equity funds" to exclude venture

<sup>22</sup> Question 221 of the Volcker Proposal asks: "Should the definition of 'covered fund' focus on the characteristics of an entity rather than whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act? If so, what characteristics should be considered and why? Would a definition focusing on an entity's characteristics rather than its form be consistent with the language and purpose of the statute?"

<sup>23</sup> *Chevron USA, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

<sup>24</sup> *Id.* at 842-43.

capital funds, whereas Senator Dodd suggested excluding venture capital investment by way of an exemption under § 13(d)(1)(J). In Sections IV.A. and IV.C., we discuss how the Agencies may use either or both of these approaches to exclude cash collateral pools from the final rule, and present further Agency authority for each approach.

*Further broad authority under § 13(b)(2) and § 5(b) of the BHC Act to carry out the purposes of the Volcker Rule.*

More generally, the Agencies have broad statutory authority to issue rules to construe the Volcker Rule in a manner that gives effect to the intent of the statute. In § 13(b)(2) of the BHC Act, Congress required that the Agencies “adopt rules to carry out this section,” and “consult and coordinate with each other” during the rulemaking process “for the purposes of assuring, to the extent possible,” that implementation of the Volcker Rule will “protect the safety and soundness of banking entities and nonbank financial companies supervised by the Board.”<sup>25</sup> Recognizing this authority, the Agencies noted in the preamble to the Volcker Proposal, “In implementing the covered funds provisions of section 13 of the BHC Act, the Agencies have proposed to define and interpret several terms used in implementing these provisions and the goals of section 13.”<sup>26</sup>

Relying on this broad interpretative and rulemaking authority, the Agencies have proposed rules that, while in some cases may depart from the express terms of the statute, give effect to the goals and intent of the Volcker Rule. For example, the Volcker Proposal’s definition of “banking entity” includes a number of important exceptions to the term,<sup>27</sup> notwithstanding the fact that the statute expressly defines “banking entity” to include “any affiliate or subsidiary of any such entity,” without exception.<sup>28</sup> In the preamble to the Proposal, the Agencies explained that this departure from the statutory text was intended to “avoid application of section 13 of the BHC Act in a way that appears unintended by the statute,”<sup>29</sup> indicating that the Agencies appear to have relied on their broad authority to “carry out” the Volcker Proposal to ensure that the term “banking entity” is interpreted in a manner consistent with the “purpose and intent of the statute.”

In addition to the Agencies’ broad rulemaking authority to implement the Volcker Rule described above, the Board has plenary statutory authority to interpret, implement and administer the BHC Act, including § 13. Specifically, § 5(b) of the BHC Act authorizes the Board to “issue such regulations and orders . . . as may be necessary to enable it to administer and carry out the purposes of this Act and prevent evasions thereof.” The Court of Appeals for the District of

<sup>25</sup> BHC Act § 13(b)(2)(A) and (B)(ii).

<sup>26</sup> Volcker Proposal at 68.928.

<sup>27</sup> Volcker Proposal § \_\_.2(c).

<sup>28</sup> BHC Act § 13(f)(1).

<sup>29</sup> Volcker Proposal at 68.855 (“[I]n order to avoid application of section 13 of the BHC Act in a way that appears unintended by the statute and would create internal inconsistencies in the statutory scheme, the proposed rule also clarifies that the term ‘banking entity’ does not include any affiliate or subsidiary of a banking entity, if that affiliate or subsidiary is (i) a covered fund, or (ii) any entity controlled by such a covered fund.”); *id.* at 68.856 (“If such a covered fund were considered a ‘banking entity’ for purposes of the proposed rule, the fund itself would become subject to all of the restrictions and limitations of section 13 of the BHC Act and the proposed rule, which would be inconsistent with the purpose and intent of the statute.”).

Columbia described § 5(b) of the BHC Act as “a general grant of power to issue regulations and orders so as to carry out the purposes of the Act,”<sup>30</sup> and the Sixth Circuit referred to it as a “broad, general grant[ ] of authority.”<sup>31</sup> The Board’s rulemaking authority under the BHC Act is expressly preserved by the Volcker Rule, which provides “Nothing in this section shall be construed to limit the inherent authority of any Federal agency or State regulatory authority under otherwise applicable provisions of law.”<sup>32</sup> Significantly, the Board has relied on § 5(b) to depart from the express terms of other sections of the Dodd-Frank Act.<sup>33</sup>

*As shown in the above discussion, Congress, the FSOC and the Agencies appear to agree that the Volcker Rule was never intended to apply to all 3(c)(1)/(7) funds. Moreover, the statute’s text (both in § 13 and elsewhere in the BHC Act), its legislative history and the FSOC Study demonstrate that Agencies have the authority to, and should, exempt funds not intended to be covered by the prohibition.*

**C. Cash collateral pools are not activities that the Volcker Rule was intended to prohibit, and should not be limited by the rulemaking.**

Cash collateral pools are traditional, regulated U.S. banking activities, whether such pools are formed in the U.S. or abroad. These pools do not engage in speculative activity involving investment of banking entities’ own capital<sup>34</sup> and thus neither (1) pose the risk to banks’ assets, nor (2) raise the conflict of interest concerns that the Volcker Rule was intended to prohibit.<sup>35</sup> As a result, either by exclusion from the definition of “covered funds” or otherwise, these pools should not be covered by the Volcker Proposal.

<sup>30</sup> *Ind. Comm. Bankers v. Bd. of Governors*, 195 F.3d 28, 31 (D.C. Cir. 1999) (emphasis added).

<sup>31</sup> *In re Bankers Trust Co.*, 61 F.3d 465, 470 (6th Cir. 1995) (emphasis added).

<sup>32</sup> BHC Act § 13(g)(3).

<sup>33</sup> See, Board, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, [] Fed. Reg. [] (stating, in support of its departure from the express terms of § 165(e) of the Dodd-Frank Act to include “sovereign entities” in its proposed credit exposure requirements to limit the vulnerability of a covered company to default by a sovereign state, despite the Act’s use of the words “any unaffiliated company” in the statutory requirements, “The Board believes that the authority in the Dodd-Frank Act and the Board’s general safety and soundness authority in associated banking laws are sufficient to encompass sovereign governments in the definition of counterparty in this manner.” (citing Section 5(b) of the BHC Act)).

<sup>34</sup> Purely as necessary to, for example, be designated as a tax matters partner for some types of pool structures, a bank may have to invest a de minimis amount of its own capital in some collateral pools. However, this amount is so insignificant as to be irrelevant for purposes of this analysis. See also, e.g., OCC Corporate Decision #2000-07, June 2000 (letter of Julie Williams Re: Mellon Bank, National Association, Pittsburgh, Pennsylvania Application to Acquire a Limited Liability Company as an Operating Subsidiary, Application Control No. 2000-NE-08-0016 (stating, in support of the bank’s application, “Furthermore, the Bank has not, directly or indirectly, invested any assets for its own account in the Fund, nor guaranteed any of the liabilities of the LLC or the Fund. The LLC’s investment in the Fund will be limited to the \$1,000 the LLC contributes to the Fund in order to serve as its general and tax matters partner”).

<sup>35</sup> We acknowledge that, as a result of the 2008 financial crisis and related market turmoil, some cash collateral pools sustained losses. In accordance with the terms of securities lending authorization agreements, lending clients were in some instances required to make contributions to collateral pools and other forms of support may have been provided by agent banks to lending clients or collateral pools. These practices did not consist of the infusion of substantial bank capital into an investment vehicle in which the agent bank held a material

*Traditional, regulated bank activities.*

Rather than a “speculative activity,” investment of cash collateral pool funds is a traditional bank activity recognized by Congress and regulators as valuable to U.S. financial markets. Regulators have acknowledged that banks have engaged in securities lending transactions and investment of cash collateral pools for many years.<sup>36</sup> For example, in connection with comments to the rules to implement the Gramm-Leach-Bliley Act, banking agencies stated that the securities lending industry has been “regulated extensively and effectively by the Banking Agencies for many years”, making it “unnecessary and inappropriate for the [SEC] to impose any additional restrictions on the securities lending activities of banks.”<sup>37</sup>

Moreover, securities lending transactions are specifically excluded from the Volcker Proposal’s definition of “trading account” used in its proprietary trading prohibition, further demonstrating that regulators do not believe the Volcker Rule should constrain this industry, particularly given the focus on proprietary trading since the proposal was published.

Congress and Agencies recognized the traditional nature and importance of securities lending activities, including, among other things, investment of cash collateral pools, by providing broad exceptions for these activities to the definition of “broker” under the Securities Exchange Act of 1934 (“Exchange Act”), as amended by the Gramm-Leach-Bliley Act, and related Regulation R. Congress recognized securities lending, among other things, as a “customary banking activity”<sup>38</sup> by specifically exempting from the definition of “broker” under the Exchange Act banks engaging in securities lending as part of their custodial services or investing cash collateral pledged in connection with such transactions.<sup>39</sup> In a comment letter to the SEC, the Board, the FDIC and the OCC noted, “In enacting this exception, Congress recognized that custodial and safekeeping activities, including providing securities borrowing and lending services as agent, are part of the core business of banking. Securities lending activities are a natural outgrowth of, and are integrally related to, the traditional custody businesses of banks and banks historically have served as the primary intermediary between securities lenders and securities borrowers.”<sup>40</sup> In 2007, the FRB and SEC adopted Rule 772 of

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ownership interest and are not the sort of activity that would generate the type of conflict of interest between banks and their customers that was intended to be prohibited by the Volcker Rule.

<sup>36</sup> See *Securities Lending*, Federal Financial Institutions Examination Council, Supervisory Policy (1985) (addressing appropriate regulatory guidelines for the growing securities lending industry) See also Interpretive Letter No. 1026 (April 27, 2005) (Re: Authority of a National Bank to Engage in Securities Lending Conduit Services); Comment Letter to the SEC from J. Virgil Mattingly, Board: William F. Kroener, FDIC; and Julie L. Williams, OCC (Dec. 10, 2002) (“2002 Comment Letter”) (on SEC’s proposed dealer rule).

<sup>37</sup> 2002 Comment Letter (giving as an example the interagency guidelines adopted by the banking Agencies to “ensure that banks conduct their securities lending activities in a safe and sound manner and consistent with sound business practices, investor protection considerations and applicable law.”)

<sup>38</sup> *Definitions of Terms and Exemptions Relating to the “Broker” Exceptions for Banks and Exemptions for Banks Under Section 3(a)(5) of the Securities Exchange Act, of 1934 and Related Rules; Final Rules*, 72 Fed. Reg. 56513 (adopted Oct. 3, 2007) (“Reg R Rulemaking”), at 56536.

<sup>39</sup> Exchange Act §3(a)(4)(B)(viii).

<sup>40</sup> 2002 Comment Letter.

Regulation R to fill a technical gap left by the earlier rulemaking to further exempt banks involved in securities lending as agent (and not custodial) banks.<sup>41</sup> Certain securities lending services, including investing, or directing the investment of, cash collateral, and indemnifying the lender of securities with respect to various matters, are also exempt under Regulation R.<sup>42</sup>

*No investment of / risk to bank capital; no Volcker prohibited conflict of interest.*

In addition to being a traditional rather than a speculative activity, cash collateral pools also do not contravene the other purposes of the Volcker Rule. More specifically, cash collateral pools do not involve the risk to banks' capital or conflict of interest that the Volcker Rule is intended to prohibit, as they do not involve the investment of a bank's own capital and agent banks are bound by fiduciary duties to their customers. The pools consist solely of the cash collateral given by the borrowers to securities lenders, which is managed by the agent banks as fiduciaries.

Further evidencing the absence of risk, both the OCC and Board capital rules give a zero percent risk weighting to securities lending transactions, including where agent banks provide indemnification of their securities lender customers, because the underlying securities loans are over 100% cash collateralized.<sup>43</sup> Because the capital rules are based on bank exposure, a zero percent risk weighting demonstrates no practical risk to bank assets.

As to the purpose to limit potential conflicts of interest, to the extent banks act as fiduciaries to securities lenders in managing the cash collateral pools, they must comply with the provisions of 12 CFR 9 relating to fiduciary duties, further reducing the potential for any conflict of interest between agent banks and their lender clients.<sup>44</sup> The Comptroller's Handbook on Custody Services specifically states "a custodian may perform functions that are fiduciary in nature. For example, a custodian exercising discretion in managing a securities lending cash collateral pool would be acting in a fiduciary capacity and must comply with the relevant provisions of 12 CFR 9."<sup>45</sup>

Agent banks demonstrate a true fiduciary purpose in operating cash collateral pools "[b]y exercising discretion in managing funds . . . and by providing related administrative services . . ."<sup>46</sup> Agent banks manage cash collateral pools in a "fiduciary capacity" as defined in 12 CFR §9.2(e), which includes acting as "trustee, executor, administrator . . .; investment adviser, if the bank receives a fee for its investment advice; any capacity in which the bank possesses investment discretion on behalf of another; or any similar capacity that the OCC authorizes pursuant to 12 U.S.C. 92a."

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<sup>41</sup> Reg R Rulemaking at 56544.

<sup>42</sup> 12 CFR §218.772(c)(5) and (6).

<sup>43</sup> See 12 CFR Part 3, App. A §3(b)(1)(v), fn 15 and related text. See also 12 CFR Part 225 App. A § III.D.1.c.

<sup>44</sup> See OCC Interpretive Letter No. 865, May 26, 1999 ("OCC Interpretive Letter No. 865").

<sup>45</sup> Comptroller of the Currency, Comptroller's Handbook: Custody Services (January 2002).

<sup>46</sup> OCC Interpretive Letter No. 865.



*Collateral pools, whether domestic or foreign, are not “similar funds” of the type meant to be limited by the Volcker Rule.*

In Section III of this outline, our analysis focuses on the core of the Volcker Rule’s definition of “covered funds”, or 3(c)(1)/(7) funds. However, both the statute and the Proposal additionally provide that the Agencies may extend the Volcker Rule’s prohibitions to any “similar fund” as they determine by rule. The Proposal includes as a “similar fund” the foreign equivalent of any entity identified as a “covered fund.”<sup>47</sup> This raises two issues that we wish to address here.

First, we submit that cash collateral pools, whether foreign or domestic, should not be deemed “similar funds” by the Agencies because, as explained above in detail, they do not in any way contravene the purposes of the Volcker Rule. More specifically, as discussed above, they do not involve any speculative trading of agent banks’ own capital, any potential conflict of interest between agent banks and their customers, or a high degree of risk to the banking entities.

Second, we emphasize that the entire discussion and analysis in this letter apply equally to foreign collateral pool funds sponsored by agent banks as they do to U.S. cash collateral pools. Thus, we request that any approach the Agencies choose to remedy the issues described in this letter be applied to both foreign and domestic funds.

*Thus, considering the traditional, already regulated nature of the securities lending industry and cash collateral pools, and the fact that banks manage cash collateral pools as fiduciaries only and not for their own accounts, such funds, whether foreign or domestic, are not part of the group of activities the Volcker Rule was intended to limit and should not be subject to the Volcker Proposal’s prohibitions or limitations.*

### **III. The Volcker Proposal: Inappropriate applicability to cash collateral pools.**

The Volcker Proposal could restrict domestic and foreign cash collateral pools, despite the fact that cash collateral pools clearly are not the type of funds the Volcker Rule was intended to prohibit and the clear legislative authority to exclude 3(c)(1)/(7) funds that are not intended to be covered. This section identifies the provisions of the Proposal applicable to cash collateral pools and analyzes how the Proposal effectively prohibits banks’ management of cash collateral pools. If implemented as proposed, we are concerned that the Proposal would contravene the legislative intent of the Volcker Rule detailed above by limiting or even precluding an agent bank’s ability to establish and maintain domestic and foreign cash collateral pools. Section IV sets out several approaches to ensure that cash collateral pools are not inappropriately limited in the final rule.

The Volcker Rule contains two basic prongs, prohibiting a banking entity from (A) engaging in proprietary trading, and (B) acquiring or retaining any ownership interest in or sponsoring a hedge fund or a private equity fund.<sup>48</sup>

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<sup>47</sup> Volcker Proposal § \_\_.10(b)(1)(iii).

<sup>48</sup> BHC Act § 13(a)(1)(A) and (B).

**A. Proprietary trading prohibition not applicable.**

Because (i) as stated above, securities lending is especially excluded from the definition of proprietary trading, and (ii) the agent bank is investing the collateral for the account of and risk of the securities lender and not itself, we submit that this activity should not fall under the Volcker Rule's proprietary trading prohibition. As such, we are focusing the main analysis of this memorandum solely on the second prohibition, implemented in § \_\_.10(a) of the Volcker Proposal.

We note, however, in response to Question 6<sup>49</sup> of the Volcker Proposal, that, because the Proposal's definition of "banking entity" includes "Any affiliate or subsidiary of any entity described [in the definition]," other than covered funds exempt under the customer funds exemption in § \_\_.11 of the Proposal, it would appear that cash collateral pools affiliated with agent banks could be considered "banking entities" and thus prohibited directly (because of the proprietary trading prohibition) from carrying out their trading activities on behalf of lending clients. As we have set forth in Section II.C., this would be an inappropriate result. We submit that this potential issue could be resolved by the Agencies in one of two ways, described in further detail below: (1) an appropriate exemption from the definition of "banking entity", or (2) an expansion of the "securities lending and borrowing" exemption from the definition of "trading account" to include related services such as the establishment and management of cash collateral pools.

**Agency action requested:** In connection with the above analysis, and in order to ensure that cash collateral pools are not improperly, inadvertently prohibited under the Volcker Proposal's proprietary trading ban, we would ask the Agencies to make one or both of the following amendments to the final rule:

1. In response to Question 6<sup>50</sup>, we request that the Agencies either add clarifying language in the preamble to, or amend the definition of "banking entities" in, the final rule to make clear that "banking entity" does not include any fund established by a banking organization acting as a securities lending intermediary or an affiliate of such banking organization, where such fund invests cash collateral pledged by one or more borrowers in connection with one or more securities lending transactions; and/or

2. In response to Questions 14<sup>51</sup> and 20<sup>52</sup> of the Volcker Proposal, we request that the Agencies supplement the existing securities lending exemption by adding the following in the definition of "trading account" under § \_\_.3(b)(2)(iii)(B):

<sup>49</sup> Question 6 of the Volcker Proposal asks: "Are there any entities that should not be included within the definition of banking entity since their inclusion would not be consistent with the language or purpose of the statute or could otherwise produce unintended results? Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not?"

<sup>50</sup> Id.

<sup>51</sup> Question 14 of the Volcker Proposal asks: "Is the proposed rule's definition of trading account effective? Is it over- or under-inclusive in this context? What alternative definition might be more effective in light of the language and purpose of the statute? How would such definition better identify the accounts that are intended to be covered by section 13 of the BHC Act?"

“(B) That arise under a transaction in which the covered banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties, or under any services provided by such covered banking entity or its affiliate to such lender in connection with such transaction, including positions taken by any fund established by a banking organization acting as a securities lending intermediary or an affiliate of such banking organization, where such fund invests cash collateral pledged by one or more borrowers in connection with one or more securities lending transactions.”

## **B. Covered fund prohibition.**

§ \_\_.10(a) of the Volcker Proposal provides: “Except as otherwise provided in this subpart, a covered banking entity may not, *as principal*, directly or indirectly, acquire or retain any *ownership interest* in or *sponsor a covered fund*.” If the final rule is adopted as proposed, we are concerned that the rule could inadvertently capture domestic and foreign collateral pools.

As discussed above, in contravention of legislative intent, the Proposal’s definition of “covered fund” includes, among other things, 3(c)(1)/(7) funds and their foreign equivalents, subject to certain exceptions not relevant here.<sup>53</sup> Many cash collateral pool funds set up by agent banks for reinvestment of cash collateral rely on Sections 3(c)(1) or (7) of the Investment Company Act to justify exemption from registration as an investment company under the Act, and as such come under the broad definition of “covered funds.”

In addition, under the Volcker Proposal, to “sponsor” includes serving as a general partner, managing member or trustee, among other things<sup>54</sup>, and “ownership interest” means “any equity, partnership or other similar interest . . . in a covered fund . . .” Agent banks have at most a nominal economic exposure to the profits and losses of cash collateral pools by way of their ownership or sponsorship interest in these pools.<sup>55</sup> Because agent banks generally have a general partnership, limited liability company membership or trustee interest in the cash collateral pools that they establish, such interest could be deemed to constitute “sponsorship” and thus to be captured by the prohibition.

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<sup>52</sup> Question 20 of the Volcker Proposal asks: “Are there particular transactions or positions that are included in the definition of trading account that should not be? If so, what transactions or positions and why?”

<sup>53</sup> Section 3(c)(1) requires that the issuer’s outstanding securities are beneficially owned by not more than 100 persons, and that the issuer is not making and does not propose to make a public offering of its securities. Section 3(c)(7) requires that the issuer’s outstanding securities are owned exclusively qualified purchasers, and that the issuer is not making and does not propose to make a public offering of such securities.

<sup>54</sup> Volcker Proposal § \_\_.10(b)(5).

<sup>55</sup> Where cash collateral pools are structured as business or other trusts, the agent bank does not invest any of its own capital in the pools as trustee. Where cash collateral pools are structured as general partnerships, or limited liability companies, as noted above in footnote 34, the agent bank may make a nominal investment in the fund in connection with its role as tax partner.

*Thus, in response to Question 225<sup>56</sup> of the Volcker Proposal, although cash collateral pools are outside of the intended scope of the Volcker Proposal's prohibitions described above, such activities could be deemed to fall within the letter of the general prohibition, and the current exceptions do not clearly exclude cash collateral pools from the prohibition. For the reasons set forth above, we respectively respond "no" to the Agencies' Question 217<sup>57</sup> of the Volcker Proposal as to whether the Proposal's definition of "covered fund" effectively implements the statute. We propose in Section IV.A alternative definitions that might be more effective in light of the language and purpose of the statute.*

**IV. Proposed Resolutions: Exclusion from "covered funds," customer fund exemption or §13(d)(1)(J) exemption.**

We propose any or all of the following approaches to align the final regulation's application to cash collateral pools, and the agent banks' credit activities with respect to them, with the intent of the Volcker Rule:

**A.** Agencies could use their rulemaking authority to narrow the definition of "covered funds" in the final rule to exclude cash collateral pools;

**B.** Agencies could make clear that the cash collateral pools managed by agent banks satisfy the requirements of the "customer fund" exemption implemented in §\_\_.11 of the Proposal, and further make clear that the "prime brokerage" exemption from Super 23A would permit typical services agent banks provide to the pools; and

**C.** Agencies could use their rulemaking authority to provide an exemption under §13(d)(1)(J) from the prohibitions contained in both §13(a)(1) and §13(f) of the BHC Act.

We submit that the best approach to implement the following proposals is in the text of the final regulation. If, however, the Agencies find it preferable to use clarifying language in the preamble to carry out any of these proposals, this may be acceptable in certain circumstances, so long as it is evident that cash collateral pools are not impaired by the final rule.

**A. Full exemption from Volcker of cash collateral pool activities pursuant to an appropriate limitation of the definition of "covered funds."**

Under this proposal, which is offered in response to Question 217<sup>58</sup> and, in the case of the second alternative described here, Question 221,<sup>59</sup> of the Volcker Proposal, the Agencies would use their rulemaking authority to revise the definition of "covered funds" in the final rule such

<sup>56</sup> Question 225 of the Volcker Proposal asks: "Are there any entities that are captured by the proposed rule's definition of 'covered fund,' the inclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?"

<sup>57</sup> Question 217 of the Volcker Proposal asks: "Does the proposed rule's definition of 'covered fund' effectively implement the statute? What alternative definitions might be more effective in light of the language and purpose of the statute?"

<sup>58</sup> Id.

<sup>59</sup> See footnote 22.

that it would exclude cash collateral pools. This could be done in one of two ways: (1) by keeping the broader definition referencing 3(c)(1)/(7) funds, and specifically excluding cash collateral pools, or (2) by re-defining the term “covered funds” using a narrower set of criteria that corresponds with traditional private equity funds and hedge funds and thus on its face excludes cash collateral pools.

Agency authority.

As discussed at length in Section II, we believe the statute’s legislative history and the FSOC Study clearly support that the Volcker Rule’s limitations should not apply to all 3(c)(1)/(7) funds, and that the Agencies have the authority to, and should, provide exceptions for funds technically falling within the broad statutory definition but that Congress did not intend to capture, such as cash collateral pools.

In addition to the legislative history, the statutory definition of “private equity funds” and “hedge funds” permits the Agencies to narrow the Proposal’s definition of “covered funds” to exclude entities such as cash collateral pools, which are not the types of entities intended to be captured by the prohibition, on two bases:

First, Congress used both the industry-recognized terms “hedge fund” and “private equity fund” in the statutory prohibition instead of using one general term defined by reference to 3(c)(1)/(7) funds (e.g., “private fund”, which is used elsewhere in the Dodd-Frank Act).<sup>60</sup> If Agencies do not give effect to the use of these two terms in implementing the definition, then every issuer that relies on Section 3(c)(1) and 3(c)(7) would be considered both a private equity fund and a hedge fund, which are understood to be two specific, different types of funds. We submit that a construction that would make all 3(c)(1)/(7) funds both private equity funds and hedge funds should be an unreasonable result and thus impermissible under *Chevron*.

Second, the Volcker Rule text provides: “The terms ‘hedge fund’ and ‘private equity fund’ mean an issuer that would be an investment company, as defined in the Investment Company Act ..., but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds **as the [Agencies] may, by rule, as provided in subsection (b)(2), determine.**”<sup>61</sup>

We believe the above text is ambiguous as to whether the phrase “as the [Agencies] may, by rule, as provided in subsection (b)(2), determine” modifies (A) both “an issuer that would be an investment company, as defined in the Investment Company Act..., but for section 3(c)(1) or 3(c)(7) of that Act” and “similar funds,” or (B) only “similar funds.” If (A), the statute does not require all 3(c)(1)/(7) funds to be included in the definition at the outset, but instead permits Agencies to exclude entities that were not intended to be captured by the definition, such as cash collateral pools, by rule. In yet another reasonable interpretation of the text, (C), the word “or”

<sup>60</sup> In contrast, *see, e.g.*, the SEC’s Form PF Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors (“**Form PF**”), which contains separate definitions for “private equity fund” and “hedge fund”, each of which begin with reference to the general term “private fund,” but are given further characteristics differentiating them from other “private funds.” Form PF defines a “private fund” as “Any issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act.”

<sup>61</sup> BHC Act § 13(h)(2) (emphasis added).

used between 3(c)(1)/(7) funds in the first part and “such similar funds as the [Agencies] may, by rule...determine” in the second part could be read (using the generally accepted meaning of the word) to provide that these are purely alternatives: thus, that the terms may be defined as “such similar funds as the Agencies may, by rule, as provided in subsection (b)(2), determine,” without any reference to 3(c)(1)/(7) funds.

Although the Agencies have clearly based their proposed definition of “covered fund” on the statutory interpretation (B) above, the interpretations (A) and (C) would lead to a result more in line with legislative intent as described above, and each would certainly be entitled to Agency deference under *Chevron*.<sup>62</sup>

Exclusion of cash collateral pools from definition of “covered funds.”

If the Agencies choose to follow interpretation (A) of the statutory definition, we would propose that Agencies amend the definition of “covered funds” in the final rule to include the following exclusion for cash collateral pools:

“(v) Notwithstanding the foregoing, a fund shall not be deemed a *covered fund* if it is established by a banking organization acting as a securities lending intermediary, or an affiliate of such banking organization, and such fund invests collateral pledged by one or more borrowers in connection with one or more securities lending transactions.”

Revised definition of “covered funds” using characteristics of private equity funds and hedge funds.

The Agencies asked in Question 221<sup>63</sup> of the Proposed Rule whether the definition of “covered fund” should focus on the characteristics of an entity rather than whether it is a 3(c)(1)/(7) fund. Under their *Chevron* authority, the Agencies may revise the Proposal’s definition of “covered funds” so that it is tailored to characteristics traditionally ascribed to hedge funds and private equity funds. This would result in a narrower definition that is less likely to include in its scope entities that were never meant to be limited by the Volcker Rule.

In order to assist the Agencies with preparing such a new, narrower definition, we propose the following definition of “covered fund,” which incorporates characteristics of traditional hedge funds and private equity funds in order to distinguish these entities from cash collateral pools. The Agencies could either use these characteristics to define “covered funds” in the negative (i.e., as funds that do not share such characteristics), or define “covered funds” using the opposite of such characteristics. We note that many of the following characteristics are derived from those characteristics listed in Question 223<sup>64</sup> of the Volcker Proposal, which, in certain cases, are in turn derived from the SEC’s Form PF.<sup>65</sup>

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<sup>62</sup> See *Chevron*, 467 U.S. 837 (1984).

<sup>63</sup> See footnote 22.

<sup>64</sup> Question 223 of the Volcker Proposal asks: “Should the Agencies consider using the authority provided under section 13(d)(1)(J) of the BHC Act to exempt the acquisition or retention of an ownership interest in a covered fund with certain attributes or characteristics, including, for example: (i) A performance fee or allocation to an investment manager’s equity account calculated by taking into account income and realized and unrealized

(1) Covered Fund means: any issuer that:

(i)(A) is organized or offered in the United States and would be an investment company as defined in the Investment Company Act, but for Section 3(c)(1) or 3(c)(7) of that Act, or (B) is privately organized or offered outside of the United States and is not subject to substantive regulation in the jurisdiction of its organization; and

(ii) possesses all of the following characteristics typical of traditional hedge funds or private equity funds: (A) payment of carried interest or other direct investment interest, or compensation otherwise based on unrealized gains, (B) use of material leverage for the purpose of increasing investment performance,<sup>66</sup> (C) use of trading or investment strategies involving selling securities short (other than for the purpose of hedging currency exposure or managing duration), (D) offers of interest to parties that do not have an existing relationship with the offeror and (E) no redemption rights provided to investors in the ordinary course.

In analyzing the traits of “covered funds” that the Volcker Rule was intended to cover, it becomes clear that cash collateral pools do not fall within the intended scope of the rule, as described below.

1. No carried interest or other direct investment interest, or compensation otherwise based on unrealized gains.<sup>67</sup>

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gains; (ii) borrowing an amount in excess of one-half of its total capital commitments or has gross notional exposure in excess of twice its total capital commitments; (iii) sells securities or other assets short; (iv) has restricted or limited investor redemption rights; (v) invests in public and non-public companies through privately negotiated transactions resulting in private ownership of the business; (vi) acquires the unregistered equity or equity-like securities of such companies that are illiquid as there is no public market and third party valuations are not readily available; (vii) requires holding those investments long-term; (viii) has a limited duration of ten years or less; or (ix) returns on such investments are realized and the proceeds of the investments are distributed to investors before the anticipated expiration of the fund’s duration? Which, if any, of these characteristics are appropriate to describe a hedge fund or private equity fund that should be considered a covered fund for purposes of this rule? Are there any other characteristics that would be more appropriate to describe a covered fund? If so, which characteristics and why?”

<sup>65</sup> In the alternative to the amended definition of “covered fund” proposed in this letter, RMA would also support use in the final rule of (x) the proposed definitions of “hedge fund” and “private equity fund” set forth in Annex C to the Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds submitted by the Securities Industry and Financial Markets Association. RMA also supports the safe harbor proposed in section II.4 of the Comment Letter on Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds jointly submitted by The Bank of New York Mellon Corporation, Northern Trust Corporation and State Street Corporation.

<sup>66</sup> “Material leverage” should be defined as, with respect to an issuer, borrowing an amount in excess of one-half of such issuer’s net asset value (including any committed capital) or having gross notional exposure in excess of twice such issuer’s net asset value (including any committed capital).

<sup>67</sup> See Form PF, paragraph (a) of definition of “hedge fund” (“with respect to which one or more investment advisers (or *related persons* of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into

As discussed above, agent banks do not hold any more than a nominal ownership interest in the cash collateral pools, and they do not earn any performance compensation based on unrealized gains (i.e., agent banks' compensation is not similar to the "2/20 economics" that is typical to many private equity or hedge funds). Instead, banks are generally compensated for the management of cash collateral pools, if at all, through a fee based on assets under management, rather than one based on cash fund performance.

2. No use of material leverage for the purpose of increasing investment performance.<sup>68</sup>

Cash collateral pools do not employ material leverage of fund assets in order to increase investment performance. In order to facilitate trade settlement and other cash collateral investment activities, certain agent banks may provide as part of their custodial functions limited extensions of credit to cash collateral pools to cover intraday and overnight overdrafts and to accommodate contractual income and settlement payments to the collateral pools, all of which are routine and customary custodial functions required to facilitate the payment and settlement of securities trades.

3. No trading or investment strategy involving selling securities short (other than for the purpose of hedging currency exposure or managing duration).<sup>69</sup>

Pooled cash collateral funds are invested in accordance with investment guidelines selected with lending clients, which generally provide for investment in liquid assets such as highly rated fixed income securities, including U.S. and non-U.S. sovereign debt (such as U.S. Treasuries, U.S. government agency securities and foreign sovereign debt), highly rated corporate debt and other similar types of securities. Collateral pools do not sell securities short, other than for the purpose of hedging currency exposure or managing duration of investments. In contrast to private equity funds and certain hedge funds, which often invest through privately negotiated transactions resulting in private ownership of the business or as part of their core business strategy acquire illiquid securities for which there may be no public market, investment guidelines of cash collateral pools provide for investment in fixed income and liquid securities.

4. Cash collateral is derived from securities lending activities offered by agent banks in connection with their overall securities lending programs.

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account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses)" (emphasis in original)). *See also* FSOC Study at 62 (listing as a characteristic to consider in connection with determining "similar funds", "Related compensation structure: Does the fund earn an allocation based on fund performance including both realized and unrealized gains?").

<sup>68</sup> *See* Form PF, paragraph (b) of definition of "hedge fund" ("that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital)"). *See also* FSOC Study at 63 (listing as a characteristic to consider in connection with determining "similar funds", "Use of leverage: Does the fund borrow or otherwise use material leverage for the purpose of increasing investment performance?").

<sup>69</sup> *See* Form PF, paragraph (c) of definition of "hedge fund." *See also* FSOC Study, at 63 ("Trading/Investment strategy: What trading or investment strategy does the fund utilize?").



Although investors in pools may in fact be a broad group of unaffiliated persons or entities,<sup>70</sup> they share the common characteristic of being securities lenders and each have a fiduciary relationship with the offeror of the cash collateral pool.

5. Securities lending transactions that underlie investments in cash collateral pools are generally short term or terminable at the request of the lender or borrower.<sup>71</sup>

Securities lending transactions are generally overnight loans, and borrowers are obliged to unwind securities lending transactions on any business day upon demand from the securities lender, requiring the return of the collateral to the borrower and the securities to the lender within the standard market settlement cycle for the loaned securities. In addition, a borrower may return securities to the lender on any business day prior to an agreed upon time and demand its collateral. Conversely, hedge funds often impose express restrictions on investor redemption rights and private equity funds do not provide investors with redemption rights in the ordinary course and often require an investor's commitment for an extended duration, such as 5 or 10 years.

Automatic exclusion from Super 23A.

As discussed in detail below in Section IV.B., it is important that certain services agent banks provide to cash collateral pools are not subject to the limitations of Super 23A. If Agencies decide to use their rulemaking authority to exclude cash collateral pools from the definition of "covered funds," this would at the same time render Super 23A (defined below) inapplicable to cash collateral pools and the services agent banks provide to them. Thus, as a drafting matter, exclusion of cash collateral pools from the definition of "covered funds" makes this important objective easier to accomplish than through a clarification or exclusion in the preamble or in the regulation to ensure such services to the pools are not impaired.

**Agency action requested:** We ask that the Agencies revise the definition of "covered fund" in the final rule either by excluding cash collateral pools or by creating a new, narrower definition based on characteristics of hedge funds and private equity funds that differentiate these types of funds from cash collateral pools, in each case as further specified above.

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<sup>70</sup> See FSOC Study, at 63.

<sup>71</sup> See Form PF, definition of "private equity fund": "Any *private fund* that is not a *hedge fund, liquidity fund, real estate fund, securitized asset fund* or *venture capital fund* and does not provide investors with redemption rights in the ordinary course" (emphasis in original).

## **B. Customer fund exemption.**

Under this approach, the Agencies would clarify in the final rule that the § \_\_.11 customer fund exemption permits the type of structure and relationship inherent in the cash collateral pools, and that the prime brokerage exception under Super 23A (defined below) would be deemed to permit typical securities lending services provided to cash collateral pools, such as lines of credit and contractual settlement.

### Exemption and purpose.

§ \_\_.11 of the Proposal, implementing §II.13(d)(1)(G) of the BHC Act (the “customer fund exemption”), permits a covered banking entity to organize and offer a covered fund, so long as it meets a number of requirements that typically would be satisfied by cash collateral pools, relating to their trust, fiduciary and investment advisory nature and limiting the potential for conflicts of interest between the bank and its clients.<sup>72</sup>

The customer fund exemption is “designed to permit a banking entity to be able to engage in certain traditional asset management and advisory businesses in compliance with section 13 of the BHC Act.”<sup>73</sup> As a traditional asset management service provided to securities lending customers (subject to compliance with these requirements as to vehicle, and investments as described above) cash collateral pools fit squarely within the purpose of this exemption.

### Conditions of exemption.

So long as services provided to cash collateral pools are deemed “prime brokerage transactions” and thus exempt from Super 23A, as discussed below, cash collateral pools would satisfy the conditions of the customer fund exemption.

First, the exemption’s conditions contained in § \_\_.11 for the most part relate to their trust, fiduciary and investment advisory nature (as opposed to any investment of the bank’s own capital or otherwise putting the bank’s capital at risk), including, e.g., that the banking entity provides *bona fide* trust, fiduciary, investment advisory or commodity trading advisory services to the fund,<sup>74</sup> that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests,<sup>75</sup> that the covered fund and banking entity do not share the

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<sup>72</sup> Volcker Proposal §§ \_\_.11(a) - (h).

<sup>73</sup> 156 Cong. Rec. S5889 (daily ed. July 15, 2010) (statement of Sen. Kay Hagan (D-NC)), as cited in Volcker Proposal at 68,900.

<sup>74</sup> See Volcker Proposal §§ \_\_.11(a) and (b). See Section II.C.2.(b) above for a discussion of how agent banks satisfy fiduciary requirements.

<sup>75</sup> See Volcker Proposal § \_\_.11(c). Such transactions are not contemplated between agent banks and managed cash collateral pools. Rather, as stated above, lending clients are expressly responsible for the performance of the pools. Regarding borrower default indemnification typically provided by agent banks directly to lending clients and funds investing in lending clients (not to the pools themselves), discussed in Section V, this only covers the narrow circumstance of a borrower default in which the mark to market value of the collateral provided by the borrower is insufficient to repurchase the loaned securities in the marketplace. As such it is

same name; and other requirements meant to protect the interests of the bank's clients. Cash collateral pools typically satisfy all of these conditions, provided that collateral pools may require some conforming changes based on the final rules governing §\_\_.11(e) and §\_\_.11(f) of the Proposal.

In addition to the conditions contained in §\_\_.11, if cash collateral pools are exempt under §\_\_.11 of the Proposal, they would remain subject to the requirements and limitations under §\_\_.15 (internal controls), §\_\_.16 (Super 23A), §\_\_.17 (prohibition of activities that would involve a material conflict of interest or material exposure to high risk assets or trading strategies, or would pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States), §\_\_.20 (compliance program) and §\_\_.21 (anti-evasion authority of the Agencies).

As a highly regulated, fiduciary service performed in compliance with investment guidelines, the internal controls and compliance program requirements are satisfied. Furthermore, as discussed throughout, the pools do not present the type of conflict of interest between agent banks and their clients that the Volcker Rule is intended to limit. Finally, as recognized by the Agencies, the pools do not pose a threat to the safety and soundness of the agent bank, and in fact enhance financial markets by providing a vital source of liquidity for domestic and global capital markets.

*Super 23A: Application to cash collateral pool services and "prime brokerage" exception.*

Pools exempt under the customer fund exemption are specifically subject to the prohibition and limitations contained in Super 23A. As discussed below, agent banks provide certain services to cash collateral pools that should not be subject to the limitations of Super 23A. The Agencies may clarify this issue by providing confirmation in the final rule or preamble thereto that such services are in fact permissible under the "prime brokerage" exception from Super 23A.

Super 23A, as implemented by §\_\_.16(a)(1) of the Proposal, provides that, subject to certain exceptions, "no covered banking entity that serves, directly or indirectly, as the investment manager, investment advisor, commodity trading advisor or sponsor to a covered fund or that organizes and offers a covered fund pursuant to §\_\_.11, and no affiliate of such entity, may enter into a transaction with the covered fund...that would be a "covered transaction" in section 23A of the Federal Reserve Act (12 U.S.C. 371c), as if such covered banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof. "Covered transactions" under Section 23A include, among other things, loans or extensions of credit to affiliates of a member bank. Because the services described below result in some short-term extensions of credit to the cash collateral pools, they would be captured under the definition of "covered transactions" as incorporated in the Proposal through Super 23A.

In response to Question 316<sup>76</sup> of the Volcker Proposal, agent banks provide services to cash collateral pools in the nature of “covered transactions,” which should not in any way be limited by Super 23A or by the Volcker Rule in general. Such services include contractual income and contractual settlement and intraday or overnight extensions of credit for overdraft protection. In connection with credit and overdraft protection, agent banks also provide liquidity to the collateral pools on a short term basis (either intraday or overnight) to meet any financial obligations of the pools. Such services are crucial to facilitating securities lending transactions and expected by participating lending clients. As stated in Section I, any “outsourcing” of such services would be uneconomical to the agent banks and restrict securities lending activities to only the largest securities lending clients, and would result in a material loss of income for other clients.

Further supporting the argument that cash collateral pools should not be subject to Super 23A, the statute’s legislative history indicates that Super 23A was included in the Volcker Rule to address the risk that banks would “bail out” the covered fund,<sup>77</sup> which is clearly not a potential risk in the case of the types of services agent banks wish to continue to provide to the pools, listed above, particularly given lending clients are expressly responsible for fund performance.

Although such services would be deemed “covered transactions” under Super 23A if it is kept in its current form in the final rule, we submit that they should nevertheless be permissible under the “prime brokerage” exception to the prohibition. §\_\_16(a)(2)(ii) of the Proposal, which implements this exception, provides that, notwithstanding Super 23A, a covered banking entity may enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored or advised by such banking entity has taken an equity, partnership or other ownership interest, subject to certain requirements.<sup>78</sup> “Prime brokerage transactions” are still subject to the restrictions of Super 23B.

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<sup>76</sup> Question 316 of the Volcker Proposal asks: “What types of transactions or relationships that currently exist between banking entities and a covered fund (or another covered fund in which such covered fund makes a controlling investment) would be prohibited under the proposed rule? What would be the effect of the proposed rule on banking entities’ ability to continue to meet the needs and demands of their clients? Are there other transactions between a banking entity and such covered funds that are not already covered but that should be prohibited or limited under the proposed rule?”

<sup>77</sup> See, e.g., Colloquy between Senators Merkley and Levin, 156 Cong. Rec. S5894 (daily ed. July 15, 2010), in which Senator Merkley stated: “[A] large part of protecting firms from bailing out their affiliated funds is by limiting the lending, asset purchases and sales, derivatives trading, and other relationships that a banking entity or nonbank financial company supervised by the Board may maintain with the hedge funds and private equity funds it advises. The relationships that a banking entity maintains with and services it furnishes to its advised funds can provide reasons why and the means through which a firm will bail out an advised fund, be it through a direct loan, an asset acquisition, or through writing a derivative . . . These bailout protections [i.e., Super 23A] will significantly benefit independent hedge funds and private equity funds, and also improve U.S. financial stability.”

See also Colloquy between Senators Merkley, Levin and Dodd, 156 CONG. REC. S5901 (daily ed. July 15, 2010) . in which Senator Merkley noted that the exception under Super 23A for prime brokerage activities with controlled portfolio funds is “not intended to permit fund-of-fund structures to be used to weaken or undermine the prohibition on bailouts.”

<sup>78</sup> We note that some commenters may view the exception as contemplating a “fund of funds” structure in its requirement that the prime brokerage transaction be “with any covered fund in which a covered fund managed, sponsored or advised by such banking entity has taken an equity, partnership or ownership interest.” Cash

The Volcker Proposal defines a “prime brokerage transaction” as “one or more products or services provided by a covered banking entity to a covered fund, such as ... securities borrowing or lending services . . .”<sup>79</sup> As traditional services provided in connection with agent banks’ securities lending programs, we believe that services provided by agent banks to cash collateral pools that might otherwise be limited by Super 23A, such as contractual income and settlement and intraday and overnight overdraft protection, should clearly fit within the definition of “prime brokerage transaction.”

The exception is available only to prime brokerage transactions meeting the following requirements, which we believe should be satisfied by cash collateral pools:

1. First, the banking entity must be in compliance with the limitations in the §\_\_.11 customer fund exemption. This is discussed in detail above in this Section IV.B.
2. Second, the CEO of the banking entity must certify annually that the banking entity does not guarantee, assume or otherwise insure any obligations or performance of the covered fund or of any covered fund in which such fund invests. As discussed above, such services do not involve the provision of any such guarantees of the performance of the cash collateral fund. We would, however, ask the Agencies to clarify in the final rule, in addition to the clarifications requested in Section V, that any short-term extensions of credit and contractual income and settlement services to lending clients and cash collateral pools to facilitate trade settlement and related cash collateral investment activities would not preclude such certification.
3. Third, the Board shall not have determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity. As set forth in Section II, cash collateral pools and related services are inherent to the structure of agent banks’ securities lending programs and are necessary to permit agent banks to continue to offer such securities lending services to a variety of lending clients.

Thus, we believe agent banks could be deemed permitted pursuant to §\_\_.11 of the Proposal (the “customer fund exemption”) to manage cash collateral pools in connection with their securities lending services, and permitted pursuant to §\_\_.16(a)(2)(ii) (the “prime brokerage” exception) to provide customary services to the pools that would otherwise be limited by Super 23A.

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collateral pools are often directly sponsored by the agent bank or its affiliate. The RMA believes such a “form over substance” requirement should not prohibit the prime brokerage exemption from being extended to securities lending pools. As such, we ask that Agencies clarify in the final rule that the prime brokerage exception permits these services to be provided to a fund directly sponsored by the agent bank.

<sup>79</sup> Volcker Proposal § \_\_.10(b)(4).

**Agency action requested:** Please clarify in the final rule or the preamble thereto that (1) funds sharing the type of structure and relationships inherent in the cash collateral pools described above meet the requirements of § \_\_.11 of the Proposal, and (2) services in the nature of the customary services provided by agent banks to their cash collateral pools described above would be deemed “prime brokerage transactions” pursuant to § \_\_.10(b)(4) and otherwise meet the requirements of § \_\_.16(a)(2)(ii). In addition, please either delete the “fund of funds” requirement from § \_\_.16(a)(2)(ii) or clarify in the final rule or its preamble that funds directly managed by banking entities or their affiliates would be eligible for the exemption despite the current language.

**C. Exemption of cash collateral pool activities pursuant to §13(d)(1)(J) authority.**

In response to Question 307<sup>80</sup> of the Volcker Proposal, we submit that cash collateral pools should be permitted pursuant to §13(d)(1)(J) of the BHC Act. As described below, cash collateral pools meet the statutory criteria of §13(d)(1)(J), which provides the Agencies with the authority to create exemptions to the Volcker Rule’s prohibitions. Under this proposal, alternatively or in conjunction with any of the approaches listed above, the Agencies would specifically exempt agent banks’ activities involving cash collateral pools from both the proprietary trading and covered fund prohibitions of the Volcker Rule pursuant to §13(d)(1)(J). We note that § \_\_.14 of the Volcker Proposal, which implements § 13(d)(1)(J), only provides exemptions for certain activities from the prohibition contained in § \_\_.10(a) (the covered fund prohibition), but not § \_\_.3(a) (the proprietary trading prohibition). However, § 13(d)(1) provides that the activities listed in that section are permitted notwithstanding the restrictions under § 13(a), which includes both the proprietary trading and covered fund prohibitions of the Volcker Rule. For the reasons set forth in footnote 5 of this letter, it is important that cash collateral pools are exempt from both the proprietary trading and covered fund prohibitions of the Volcker Rule. If the Agencies choose the approach set forth in this Section IV.C. to address the exemption of cash collateral pools from the final rule, but choose not to expand § \_\_.14 in the final rule to exempt the activities listed in that section from both § \_\_.3(a) and § \_\_.10(a), we would request that the Agencies additionally clarify that cash collateral pools would not be deemed “banking entities” as requested in Section IV.A. and explained in footnote 5. Furthermore, in response to Question 303<sup>81</sup> of the Proposal, we submit that the Agencies should exempt cash collateral pools and related services provided by agent banks from Super 23A pursuant to the authority under §13(d)(1)(J) described below in addition to the Board’s plenary authority under the Federal Reserve Act discussed above in Section II.B.

<sup>80</sup> Question 307 of the Volcker Proposal asks: “Does the proposed rule effectively cover the scope of covered funds activities which the Agencies should specifically determine to be permissible under section 13(d)(1)(J) of the BHC Act? If not, what activity or activities should be permitted? For additional activities that should be permitted, on what grounds would these activities promote and protect the safety and soundness of banking entities and the financial stability of the United States?”

<sup>81</sup> Question 303 of the Proposal asks: “Is the proposed rule’s approach to utilizing section 13(d)(1)(J) of the BHC Act to permit a banking entity to acquire or retain an ownership interest in, or act as sponsor to, certain entities that would fall into the definition of covered fund effective? Why or why not? If not, what alternative would be more effective and why? What legal authority under the statute would permit such an alternative?”

Agency authority to exempt cash collateral pools pursuant to §13(d)(1)(J).

It is within the Agencies' authority to create exceptions for certain additional activities under §13(d)(1)(J) of the BHC Act that the Agencies determine promotes and protects the **safety and soundness of a banking entity** and the **financial stability of the United States**<sup>82</sup>. As detailed below, cash collateral pools are of the type of activity that §13(d)(1)(J) was intended to allow the Agencies to permit,<sup>83</sup> however, the Agencies omitted an exemption for cash collateral pool activities in the section of the Proposal implementing §13(d)(1)(J)<sup>84</sup>.

Cash collateral pools meet the "safety and soundness" prong of §13(d)(1)(J). As discussed at length in Section II.C., securities lending and its ancillary services are core banking activities at the agent banks, recognized as such by regulators by way of interagency guidelines and other policies regarding the securities lending industry instituted by the agencies over the years.<sup>85</sup> The returns generated by securities lending and ancillary services, including investment of cash collateral provide a significant source of revenue for lending clients, which is often used to offset fees for other services the lending clients receive from the agent bank, such as custodial or advisory services. Lending revenue also defrays management fees, allowing agent banks to maintain reasonable fees for clients such as public and private pension plan investors. Additionally, securities lending and cash collateral investment are a key source of revenue for agent banks. Requiring that these pools be outsourced to third parties would severely dampen certain potential securities lenders' ability to defray costs associated with lending out their securities, which would likely cause a reduction in the total number of securities available for loan in the market.

Regarding the "financial stability" prong of §13(d)(1)(J), securities lending improves market liquidity by effectively increasing the supply of securities available for market-making, trade settlement and other market activities, and potentially increases market efficiency by reducing the cost of trading. Notably, the Federal Reserve Bank of New York regularly conducts its own securities lending activities, and even instituted a special securities lending program during the financial crisis, "intended to promote liquidity in the financing markets for Treasury and other collateral and thus to foster the functioning of financial markets more generally."<sup>86</sup>

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<sup>82</sup> See Volcker Proposal, fn 311: "Section 13(d)(1)(J) of the BHC Act provides the Agencies discretion to determine that other activities not specifically identified by Sections 13(d)(1)(A)–(I) of the BHC Act are exempted from the general prohibitions contained in Section 13(a) of that Act, and are thus permitted activities. In order to make such a determination, the Agencies must find that such activity or activities promote and protect the safety and soundness of a banking entity, as well as promote and protect the financial stability of the United States."

<sup>83</sup> As in the case of covered funds exempt under the customer fund exemption, activities exempt pursuant to § \_\_.14 are still subject to §§ \_\_.15, \_\_.17, \_\_.20 and \_\_.21 of the Proposal.

<sup>84</sup> Volcker Proposal § \_\_.14.

<sup>85</sup> See, e.g., Securities Lending, Federal Financial Institutions Examination Council, Supervisory Policy (1985); see also 2002 Comment Letter.

<sup>86</sup> See Term Securities Lending Facility: Frequently Asked Questions, Federal Reserve Bank of New York (effective June 25, 2009), available at [http://www.newyorkfed.org/markets/tslf\\_faq.html](http://www.newyorkfed.org/markets/tslf_faq.html).

*Agency authority to further exempt cash collateral pools from Super 23A pursuant to §13(d)(1)(J).*

The Agencies stated in footnote 313 to the Volcker Proposal their opinion that §13(d)(1)(J) of the BHC Act does not provide them with the ability to make exemptions to §13(f) of the BHC Act, which contains Super 23A. For the reasons provided below, we respectfully disagree.

The Agencies have interpreted the statutory text's silence on whether §13(d)(1)(J) gives Agencies the authority to exempt activities from §13(f), including Super 23A, as an absence of that authority. However, as explained below, we believe that other statutory text, including in §13(d)(1) and §13(f)(1), indicates that the opposite (i.e., that §13(d)(1)(J) does provide the Agencies with the authority to exempt activities from §13(f)) could arguably be concluded from such silence.

The Agencies stated in footnote 313 to the Proposal that they do not believe §13(d)(1)(J) gives them the authority to make any exemptions to Super 23A or the rest of §13(f) of the BHC Act, because §13(d)(1)(J) "only provides the Agencies with the ability to provide additional exemptions from the prohibitions contained in section 13(a)(1) of the BHC Act." To come to this conclusion, the Agencies rely on the statutory text in the lead-in to §13(d)(1), which provides that the activities listed in that section are permitted "notwithstanding the restrictions under subsection [13](a)." Taking this approach, however, produces plainly unintended results -- for example, the Agencies' approach results in Super 23A prohibiting transactions between the non-U.S. offices of foreign banks and non-U.S. funds. There is no evidence Congress intended such an outcome or that such an extra-territorial application of Super 23A is warranted.

This example, in our view, highlights the need to tailor more finely the application of the restrictions in Section 13(f). The statute, we submit, allows the Agencies to do this. First, it is silent on the restrictions of §13(f). Rather, the statute provides that any activity exempt pursuant to §13(d)(1) is specifically subject to the limitations under §13(d)(2)<sup>87</sup> "and any restrictions or limitations that the appropriate [Agencies]...may determine."<sup>88</sup> It does not provide that such activities must be subject to Super 23A. Thus, we believe this silence arguably operates to provide more flexibility to the Agencies under §13(d)(1)(J), not less.

Furthermore, §13(f)(1) provides that Super 23A is specifically applicable to funds exempt under the customer fund exemption (§13(d)(1)(G)), but is silent as to Super 23A's applicability to the other exemptions under §13(d)(1), including §13(d)(1)(J). We believe this provides flexibility for the Agencies to use their authority under §13(d)(1)(J) to exempt from Super 23A any activities they deem necessary.

If it was Congress' intent that activities exempt pursuant to §13(d)(1)(J) (or any other exemption under §13(d)(1), other than (d)(1)(G)), should be subject to Super 23A without

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<sup>87</sup> Prohibition of activities that would involve a material conflict of interest or material exposure to high risk assets or trading strategies, or would pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States, implemented in §\_\_\_.17 of the Proposal.

<sup>88</sup> BHC Act § 13(d)(1).



exception, Congress had the opportunity to specify this in the provisions of §13(d)(1) or §13(f)(1). It did not. Moreover, legislative history indicates that Congress did not intend §13(f) to apply without exception in all circumstances. Specifically, Senator Kay Hagan (N-DC) noted that Super 23A should not limit “normal banking relationships” with a fund sponsored by the banking entity.<sup>89</sup> The traditional services agent banks provide to cash collateral pools discussed in this section are an example of such “normal banking relationships” that should be exempt from prohibition.

Thus, we believe that, under *Chevron*,<sup>90</sup> it is entirely in the Agencies’ broad authority under §13(d)(1)(J) to clarify in a (d)(1)(J) exemption for cash collateral pools that such funds would also be exempt from Section 23A.

**Agency action requested:** We request that the Agencies add a new exemption under §\_\_.14 or elsewhere in the Volcker Proposal for cash collateral pools pursuant to their authority under §13(d)(1)(J), and provide that such activities are exempt from each of §\_\_.3(a), §\_\_.10(a) and §\_\_.16(a) of the Proposal.

**V. Borrower default indemnification services provided by agent banks to certain clients in connection with securities lending services should be permitted under the Volcker Proposal.**

In this section, we address borrower default indemnification services that agent banks customarily provide in connection with securities lending transactions, and seek clarification that:

(1) §\_\_.11(e) of the Proposal would not be interpreted to prohibit such indemnification of borrower defaults to certain securities lenders and other clients, and

(2) such services would be exempt from any inappropriate application of Super 23A, either due to the fact that they are not “covered transactions” as such term is incorporated in Super 23A or pursuant to the “prime brokerage” exemption.

**A. Indemnification services as customary to securities lending transactions and separate from activities Volcker was intended to prohibit.**

As part of their securities lending services, banks customarily provide borrower default indemnification to clients, which covers certain types of collateral shortfall upon a borrower default.

<sup>89</sup> See Senator Hagan’s statement, “[Section] 619F does not limit in any manner transactions and normal banking relationships with a fund not ‘controlled’ by the banking entity or a fund sponsored by the banking entity.” 156 Cong. Rec. S5889 (daily ed. July 15, 2010).

<sup>90</sup> 467 U.S. 837 (1984). See also *INS v. Cardoza-Fonseca*, 480 U.S. 421, 454 (Scalia, J., concurring in the judgment) (restates approvingly the *Chevron* rule of deference); *NLRB v. United Food & Commercial Workers Union, Local 23*, 484 U.S. 112, 133 (1987) (Scalia, J., concurring) (*Chevron* requires deference to agency whenever a statute is ambiguous or silent on an issue).

Types of clients receiving this type of indemnification include:

1. securities lending clients, which may be 3(c)(1)/(7) “customer funds” (“Lending Customer Funds”);
2. certain clients, such as pension funds, that invest in Lending Customer Funds (“Indemnified Client Investors”); and
3. securities lending clients that are 3(c)(1)/(7) funds advised/subadvised by the agent bank or its affiliate, but which are not “customer funds” (“Lending Advised/Subadvised Funds”).

Diagrams showing the relationship of each of these clients with an agent bank are attached as Exhibits B-1, B-2 and B-3.

Such indemnification services have been customary (and necessary) ancillary services to securities lending practices for years, and the prohibition of these services would be severely detrimental to agent banks’ securities lending practices, which, as previously discussed, would disrupt a core activity of the U.S. banking industry and the reduce the liquidity of the U.S. capital markets.

Evidencing Agencies’ recognition that this is a common, important, traditional bank activity, as discussed above in Section II.C., indemnification of the lender of securities with respect to various matters is one of several securities lending services specifically excepted under Regulation R exemptions from the definition of “broker.” Furthermore, also as noted above, securities lending is specifically exempt from the proprietary trading prohibition of the Volcker Rule. In addition, regulators such as the U.S. Department of Labor have encouraged the provision of borrower default indemnification by lending agents to employee benefit plans that participate in securities lending.<sup>91</sup>

These services provide comfort particularly to lending clients, such as pension and government plans, seeking incremental income from their portfolio with limited risk. The indemnification provided covers only the difference between the mark to market amount of the collateral and the repurchase price of the securities. Thus, given the excess collateral required for the loans, it is extremely rare for such indemnification to be utilized. Further evidencing the absence of risk, as previously noted in Section II.C, both the OCC and Board capital rules give a zero percent risk weighting to transactions where agent banks provide indemnification of their securities lender customers, because the underlying securities loans are over 100% cash

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<sup>91</sup> See Prohibited Transaction Exemption (PTE) 2006-16, Class Exemption To Permit Certain Loans of Securities by Employee Benefit Plans (Oct. 31, 2006), which requires, e.g., in the case of a securities lending transaction involving certain types of foreign banks or broker-dealers, that a U.S. bank or broker-dealer “lending fiduciary” indemnifies the lending plan with respect to the difference, if any, between the replacement cost of the borrowed securities and the market value of the collateral on the date of a borrower default plus interest and any transaction costs which the plan may incur or suffer directly arising out of a borrower default.

collateralized.<sup>92</sup> Such treatment demonstrates that Agencies recognize that such indemnification does not put banks' capital at risk.

**B. §\_\_.11(e) of the Volcker Proposal should not be interpreted to limit indemnification services customarily provided to Lending Customer Funds or Indemnified Client Investors.**

In the case of Lending Customer Funds and Indemnified Client Investors only (but not Lending Subadvised Funds), the relevant lending clients may be considered customer funds of the agent bank (see Exhibit B-1). If that is the case, when the final rule is effective, the agent bank will seek exemption for such lending clients from the Volcker Proposal's covered fund establishment prohibitions under §\_\_.11's fiduciary exception. Indemnification for borrower default may be provided to either Lending Customer Funds or to Indemnified Client Investors that invest in such funds.

The Lending Customer Funds to which the banking entity is providing *bona fide* trust, fiduciary or investment advisory services under the proposed transactions are in general separate and distinct entities from the banking entity, and subject to Agency confirmation of the limited points raised below in this Section IV, the agent banks are clearly in compliance with the requirements of §13(d)(1)(G)/§\_\_.11, including §\_\_.11(e). As discussed above in Section IV.B., §\_\_.11(e) requires that a banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of a covered fund or of any covered fund in which such covered fund invests, transactions which are not contemplated between agent banks and managed cash collateral pools.

We submit that §\_\_.11(e)'s prohibitions do not encompass any guarantee of collateral sufficiency upon a securities borrower's default, which is the effect of indemnification services discussed here. In the event the indemnification is used, the agent bank indemnifies the lending client or an investor in the lending client only in the narrow circumstance of a borrower default in which the mark to market value of the collateral provided by the borrower is insufficient to repurchase the loaned securities in the marketplace. If indemnification were in fact required after application of the cash collateral provided, it would only involve the deficit between the mark to market value of cash collateral received and the amount of the borrower default. This is different in kind from the type of general investment performance or obligation guarantee of the customer fund contemplated in the Volcker Rule. This reading also makes §\_\_.11(e) consistent with the prime brokerage exception to Super 23A, discussed below.

**C. Borrower default indemnification services should not be limited by Super 23A, and in any event should be exempt from any potential application of Super 23A under the "prime brokerage" exception.**

As stated above, Super 23A, as implemented by §\_\_.16(a)(1) of the Proposal, provides that, subject to certain exceptions, "no covered banking entity that serves, directly or indirectly, as the investment manager, investment advisor, commodity trading advisor or sponsor to a covered fund or that organizes and offers a covered fund pursuant to §\_\_.11 [customer fund

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<sup>92</sup> See 12 CFR Part 3, App. A §3(b)(1)(v), fn 15 and related text. See also 12 CFR Part 225 App. A § III.D.1.c.

exemption], and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction in section 23A of the Federal Reserve Act (12 U.S.C. 371c), as if such covered banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.” “Covered transactions” include, among other things, loans or extensions of credit to, and guarantees on behalf of, affiliates of a member bank.

We submit that borrower default indemnification services should not be considered “covered transactions”, because as stated above they do not involve any bank guarantee of fund performance or credit exposure to the fund. Borrower default indemnification provided to Lending Customer Funds, Indemnified Client Investors and Lending Subadvised Funds solely on account of borrower default are in fact guarantees of the borrower’s obligations. This “broker default” indemnification in no way guarantees the overall performance of the relevant covered fund, does not result in any credit exposure to the covered fund and certainly in no way obligates the agent bank to “bail out” the covered fund in the manner contemplated by the Volcker Rule. As a result, we strongly submit that provision of borrower default indemnification should not be deemed a “covered transaction” as such term is incorporated in Super 23A, and thus should not be subject to Super 23A.

Further to the above analysis, we do not believe that the “attribution rule” under Section 23A of the Federal Reserve Act<sup>93</sup> is incorporated in Super 23A, because Super 23A only references the statutory definition of “covered transactions.” Thus, borrower default indemnification services would not inappropriately be deemed “covered transactions” merely because the proceeds of such transactions may be provided to the relevant covered funds.

*Prime brokerage exception from Super 23A.*

In the event borrower default indemnification services provided to Lending Customer Funds, Indemnified Client Investors and/or Lending Subadvised Funds are for some reason deemed “covered transactions” subject to Super 23A, these services should be exempt from Super 23A’s limitations pursuant to the “prime brokerage” exception outlined above in Section IV.A.4.(d).<sup>94</sup> As discussed below, lender indemnification services should meet each requirement of the prime brokerage exception.

First, indemnification services have been for years customarily provided as part of an agent bank’s securities lending services to its securities lending clients, and as such are an example of “securities borrowing or lending services” under the Volcker Proposal’s definition of “prime brokerage transactions.”<sup>95</sup> Next, regarding the requirement that the banking entity comply with § \_\_.11, as discussed above in Section V.B, we believe indemnification services provided to lender customer funds comply in all respects with § \_\_.11 of the Volcker Proposal.

<sup>93</sup> See 12 U.S.C. § 371c(a)(12) (“For purposes of this section, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.”) See also 12 CFR 223.16(a).

<sup>94</sup> Volcker Proposal § \_\_.16(a)(2)(ii).

<sup>95</sup> See Volcker Proposal § \_\_.10(b)(4).

Next, regarding the required CEO certification, for the same reasons mentioned in Section V.B, we do not believe indemnification services should impose any impediment for the bank's CEO to provide certification that the banking entity does not guarantee, assume or otherwise insure any obligations or performance of the covered fund or of any covered fund in which such fund invests. Specifically, these services involve indemnification by the agent bank of the securities borrower's obligations, not of the fund's obligations or performance. Finally, such indemnification services are consistent with the safe and sound operation and condition of the banking entity. Indemnification services long been provided as customary services in connection with securities lending transactions, and are an inherent part of the structure of typical securities lending transactions. Moreover, loans are fully collateralized by the borrowers, with cash collateral invested in high quality assets, and given a zero percent risk weighting under capital rules. (See Section II.C.)

**Agency action requested:** Please provide clarification in the preamble to the final rule that (1) §\_\_ .11(e) of the Volcker Proposal would not be interpreted to prohibit indemnification services customarily provided to customer funds or clients invested in customer funds in connection with banks' securities lending practices, and (2) either (A) such indemnification services would not be deemed "covered transactions" limited by Super 23A or (B) if such services are deemed "covered transactions", such services are exempt from the limitations of Super 23A pursuant to the exception for prime brokerage transactions.

## **VI. Conclusion**

In conclusion, we reiterate that, based on Congress' clear intent as to the applicability of the Volcker Rule, it would be inappropriate for the final rule to inhibit the operation of banks' traditional securities lending activities, including investment of cash collateral pools and borrower default indemnification. As discussed in detail in this letter, the Agencies are authorized by statute's text and legislative history to use one or more approaches to bring the final rule more clearly in line with the intended scope of the statute, to ensure that these activities are not limited or prohibited by the rule.

If the Proposal is not modified to accommodate one of the approaches proposed above or otherwise exempt cash collateral pools from the broad reach of the Volcker Rule, including Super 23A, agent banks will require a significant amount of time to bring collateral pools into compliance with the final rule. A general two-year conformance period was adopted by the Federal Reserve pursuant to §13(c) of the BHC Act.<sup>96</sup> Significantly, nothing in the statutory text of the Volcker Rule suggests that the two-year conformance period is only intended for existing activities; §13(c) simply states: "A banking entity . . . shall bring its activities and investments into compliance with the requirements of this section not later than 2 years after the date on which the requirements become effective pursuant to this section."<sup>97</sup> However, the Proposal suggests that the conformance period would not permit an agent bank to engage in any new activity, including managing any existing collateral pools while transitioning to structures that

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<sup>96</sup> Federal Reserve, Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 12 CFR 225.180-182.

<sup>97</sup> BHC Act § 13(c).

conform to the Volcker Rule or providing short-term credit to new or existing collateral pools, without complying with the restrictions and prohibitions in §13 of the BHC Act and implementing rules thereunder.<sup>98</sup>

The ambiguity of the conformance period raises a risk that collateral pools will need to liquidate rapidly in order to facilitate conversion of collateral pools to a structure that conforms to the Volcker Rule. It also raises a risk that during the two-year conformance period each short-term extension of credit to a covered fund would be viewed as a new activity and therefore not benefit from the two-year conformance period. Such risks pose an actual threat to the stability of securities lending programs of RMA member firms, which in turn threatens the earning potential of participating lending clients and the domestic and global market liquidity that is provided by securities lending. It is unreasonable to require the agent banks to conform their securities lending programs, including collateral investment pools, to the Volcker Proposal by July 21, 2012.

Accordingly, should the Agencies decide not to exclude securities lending collateral pools from the broad reach of the Volcker Rule, the Agencies should, at a minimum, permit agent banks to gradually transition their securities lending programs and any existing or new collateral pools in an orderly fashion during the two-year statutory conformance period.

We appreciate the opportunity to file this letter with the Agencies as they prepare the final rulemaking implementing this important piece of legislation.

Sincerely,

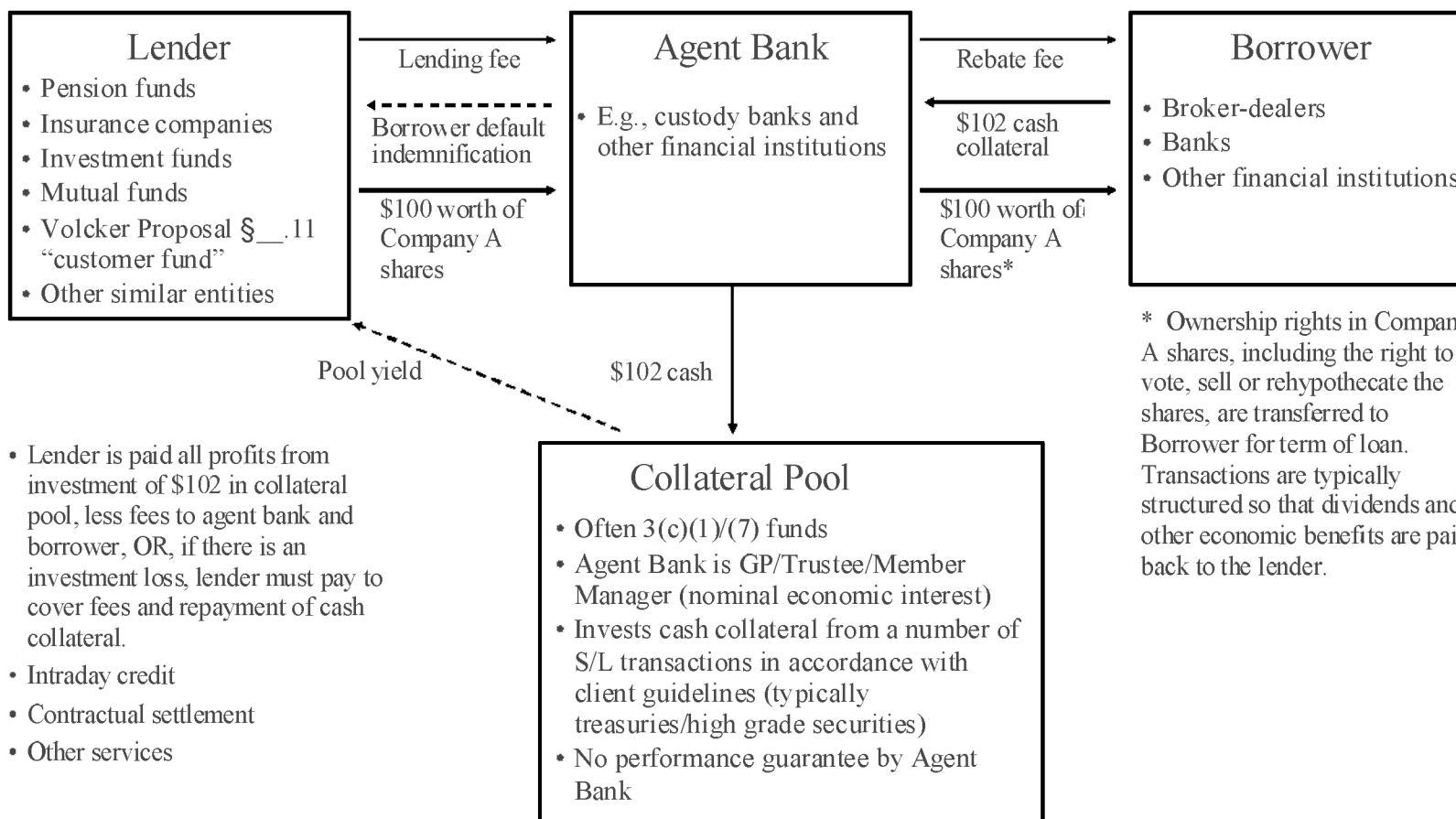
**Christopher R. Kunkle**  
Director Securities Lending  
The Risk Management Association

**Michael P. McAuley**  
Chairman RMA Executive Committee  
The Risk Management Association

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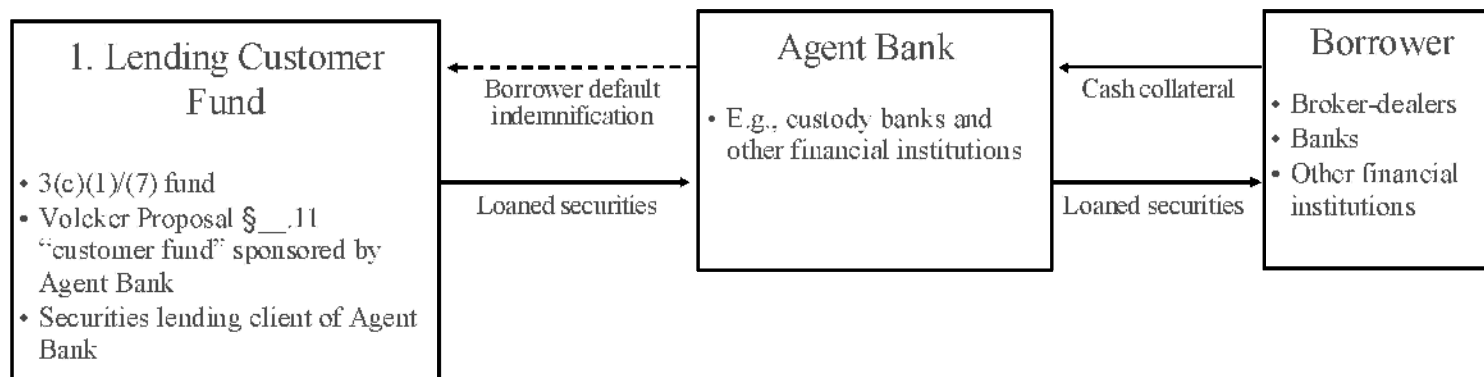
<sup>98</sup> Volcker Proposal at 68,923.

# Typical Securities Loan Structure (Cash Collateral)



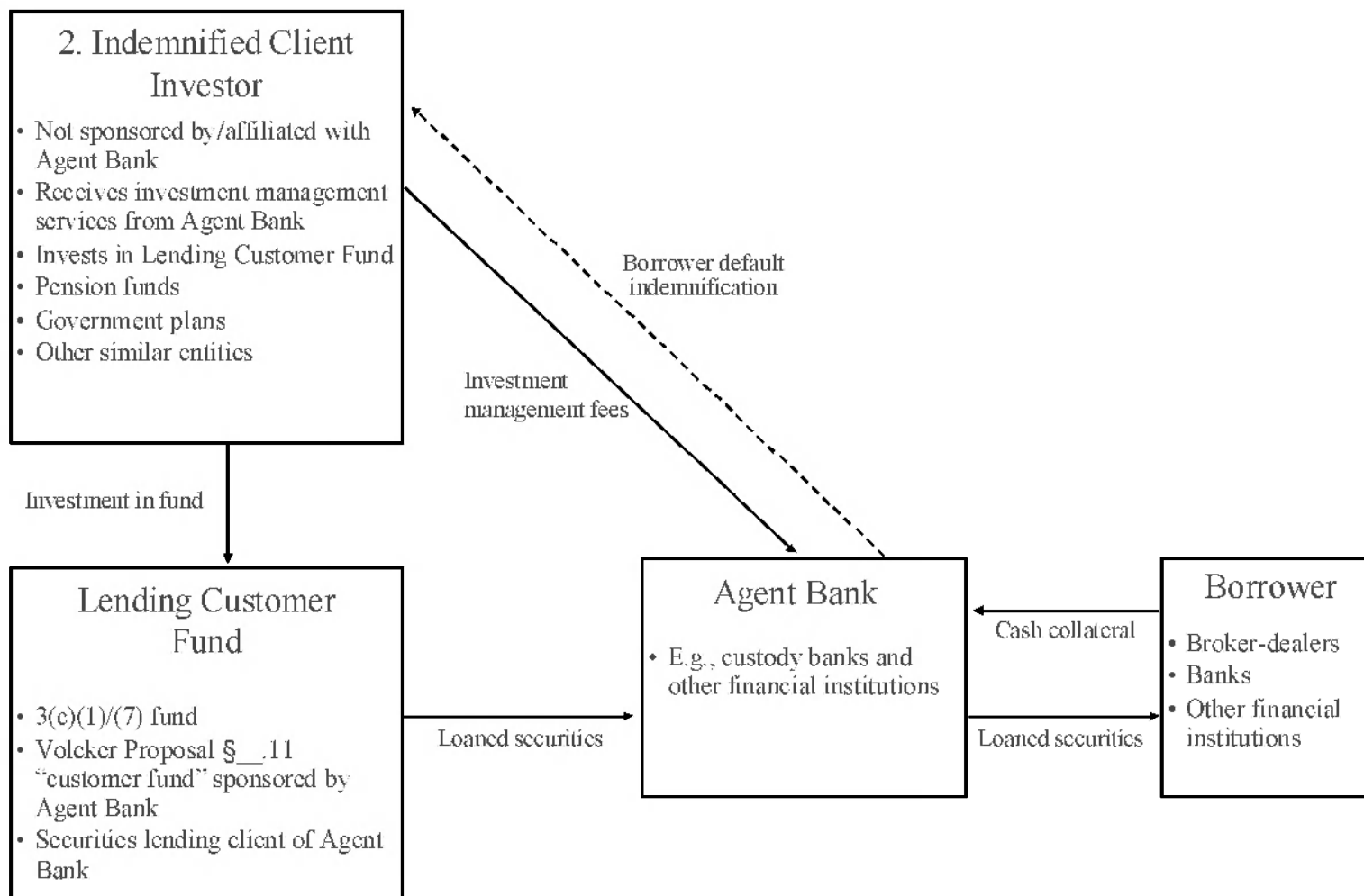
- Lender is paid all profits from investment of \$102 in collateral pool, less fees to agent bank and borrower, OR, if there is an investment loss, lender must pay to cover fees and repayment of cash collateral.
- Intraday credit
- Contractual settlement
- Other services

**Borrower Default Indemnification: Relevant Relationships between Agent Bank and Indemnified Clients**  
(Lending Customer Fund)





**Borrower Default Indemnification: Relevant Relationships between Agent Bank and Indemnified Clients  
(Indemnified Client Investor)**



**Borrower Default Indemnification: Relevant Relationships between Agent Bank and Indemnified Clients**  
(Lending Advised/Subadvised Fund)

